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Monetary policy report

Report to the attention of the Governing Board of the Swiss National Bank
for its quarterly assessment of June 2011

This report is based primarily on the data and information available
as at 16 June 2011.

Monetary policy report

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About this report

The Swiss National Bank (SNB) has a statutory mandate to pursue a monetary policy serving the interests of the country as a whole. It ensures price stability while taking due account of economic developments.

It is a particular concern of the SNB that its monetary policy be understood by a wider public. Moreover, it is obliged by law to inform regularly of its policy and to make its intentions known. This monetary policy report performs both of these tasks. It describes economic and monetary developments in Switzerland and explains the inflation forecast. It shows how the SNB views the economic situation and the implications for monetary policy it draws from this assessment.

Sections 2–3 of the present report were drawn up for the Governing Board's assessment of June 2011. Section 1 ('Inflation forecast and monetary policy decision') is an excerpt from the press release published following the monetary policy assessment of 16 June 2011.

Unless otherwise stated, all rates of change from the previous period are based on seasonally adjusted data and are annualised.

1 Inflation forecast and monetary policy decision

At its monetary policy assessment of 16 June 2011, the Swiss National Bank (SNB) decided to maintain its expansionary monetary policy. The target range for the three-month Libor remains at 0.0–0.75%, and the SNB intends to keep the Libor within the lower part of the target range at around 0.25%.

The global economic recovery is continuing, even if the outlook has dampened somewhat in the past few weeks. The level of capacity utilisation in the Swiss economy is rising. Despite the strong appreciation of the Swiss franc, the economy continues to benefit from robust international demand. However, margins in the export industry are coming under increasing pressure. For 2011, the SNB is maintaining its forecast of real growth in Swiss GDP of around 2%.

Overall, however, downside risks predominate. These include, in particular, the debt problems in the euro area periphery. In addition, high deficits require several countries in various parts of the world to undertake fiscal consolidation measures, economic fragility notwithstanding. The recent commodity price increase weighs on global economic growth and poses upside risks to inflation. In Switzerland, the main risks remain, on the one hand, the effects of the strong Swiss franc on the

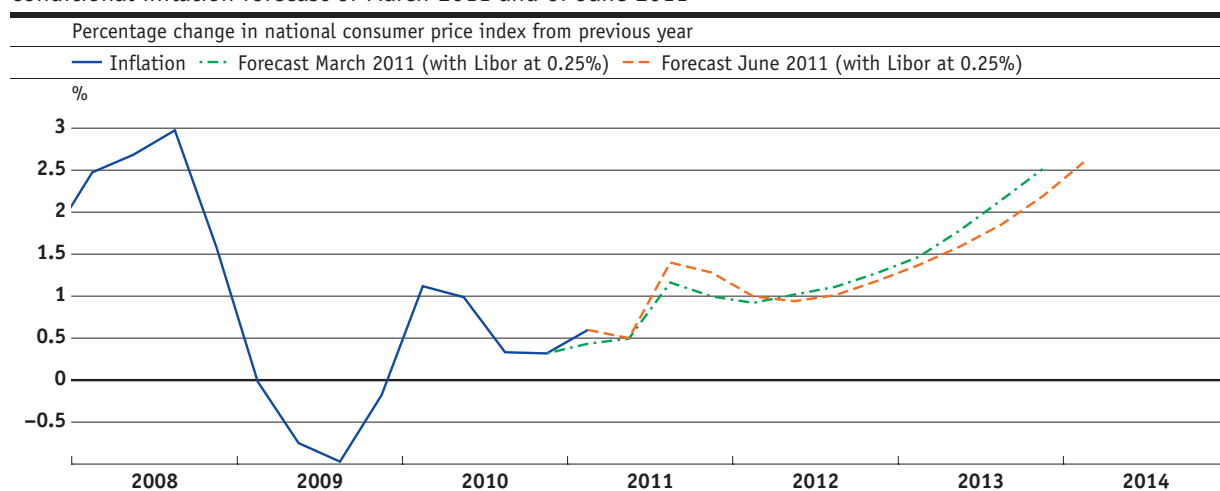
export industry and, on the other, the danger of overheating in the real estate sector.

Chart of conditional inflation forecast

The new conditional inflation forecast is depicted in chart 1.1. It shows the future path of inflation, assuming that the three-month Libor remains constant at 0.25% over the next twelve quarters, and it covers the period from the first quarter of 2011 to the first quarter of 2014. For purposes of comparison, the chart also depicts the conditional inflation forecast published in March, which was also based on the assumption of a three-month Libor of 0.25%.

Until the beginning of 2012, the path of the SNB's new conditional inflation forecast lies above that of the previous quarter's forecast. This is attributable to the assumption of higher oil prices compared to the previous quarter and somewhat higher import prices. The significant increase in the third quarter of 2011 is due to a base effect, because inflation in the corresponding quarter of 2010 was comparatively low. In addition, a one-off statistical effect can be expected in the third quarter of 2011. This is attributable to more frequent data collection in the case of prices for clothing and shoes; it also accounted for an increase in inflation in the first quarter. During the course of 2012, the path of the new forecast falls below that of March, due to the slowdown in inflation attribut-

Chart 1.1
Conditional inflation forecast of March 2011 and of June 2011



Source: SNB

able to the latest appreciation in the Swiss franc and the slightly slower development of international growth. Towards the end of the forecast period, inflation rises briskly and exceeds the upper bound of 2%. This shows that the current expansionary monetary policy cannot be maintained over the entire forecast horizon without compromising price stability in the long term.

Assuming an unchanged three-month Libor of 0.25% over the forecast horizon, the SNB expects average inflation rates of 0.9% for 2011, 1.0% for 2012 and 1.7% for 2013. Due to the risks mentioned previously, the conditional inflation forecast is, however, associated with a high level of uncertainty.

Observed inflation in June 2011

Table 1.1

| | 2008 | | | | 2009 | | | | 2010 | | | | 2011 | | | | 2008 | 2009 | 2010 |
|-----------|------|-----|-----|-----|------|------|------|------|------|-----|-----|-----|------|----|----|----|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | | | |
| Inflation | 2.5 | 2.7 | 3.0 | 1.6 | 0.0 | -0.7 | -1.0 | -0.2 | 1.1 | 1.0 | 0.3 | 0.3 | 0.6 | | | | 2.4 | -0.5 | 0.7 |

Conditional inflation forecast of March 2011 with Libor at 0.25% and of June 2011 with Libor at 0.25%

| | 2011 | | | | 2012 | | | | 2013 | | | | 2014 | | | | 2011 | 2012 | 2013 |
|-------------------------------------|------|-----|-----|-----|------|-----|-----|-----|------|-----|-----|-----|------|----|----|----|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | | | |
| Forecast March 2011, Libor at 0.25% | 0.4 | 0.5 | 1.2 | 1.0 | 0.9 | 1.0 | 1.1 | 1.3 | 1.5 | 1.8 | 2.1 | 2.5 | | | | | 0.8 | 1.1 | 2.0 |
| Forecast June 2011, Libor at 0.25% | | 0.5 | 1.4 | 1.3 | 1.0 | 0.9 | 1.0 | 1.2 | 1.4 | 1.6 | 1.8 | 2.2 | 2.6 | | | | 0.9 | 1.0 | 1.7 |

Source: SNB

Inflation forecasting as part of the monetary policy strategy

The SNB has a statutory mandate to ensure price stability while taking due account of economic developments.

The SNB has specified the way in which it exercises this mandate in a three-part monetary policy strategy. First, it regards prices as stable when the national consumer price index (CPI) rises by less than 2% per annum. This allows it to take account of the fact that the CPI slightly overstates actual inflation. At the same time, it allows inflation to fluctuate somewhat with the economic cycle. Second, the SNB summarises its assessment

of the situation and of the need for monetary policy action in a quarterly inflation forecast. This forecast, which is based on the assumption of a constant short-term interest rate, shows how the SNB expects the CPI to move over the next three years. Third, the SNB sets its operational goal in the form of a target range for the three-month Swiss franc Libor. The target range provides the SNB with a certain amount of leeway, enabling it to react to unexpected developments in the money and foreign exchange markets without having to change its basic monetary policy course.

2 Global economic environment

Economic growth continued worldwide in the first quarter, although there were considerable regional differences. As in the previous quarters, the emerging economies recorded the highest growth rates. In the euro area, particularly Germany, the recovery was supported by strong export and investment activity. In the US, by contrast, high energy prices weighed on sentiment and held back growth. In addition, the persistent crisis on the real estate market is hampering the economic recovery. In Japan, there was a significant decline in GDP as a result of the earthquake.

Although the international economic outlook is somewhat less favourable than in March, the upswing in the global economy is likely to be maintained in the months ahead. In the US, in particular, the latest production and labour market indicators have been disappointing. Due to the high commodity prices and the production losses in Japan, the SNB has revised its 2011 growth forecast for the advanced economies downwards to some extent. Moreover, numerous countries are planning to undertake additional cost-cutting measures in the year ahead. The rise in commodity prices since autumn of last year is expected to result in significantly higher inflation worldwide in 2011.

2.1 International financial and commodity markets

The recovery on the international equity markets has slowed considerably since the start of the year. Share prices are being depressed by the earthquake in Japan, the debt problems in the euro area periphery and lower growth expectations. In mid-June, therefore, prices were still below the level they had reached before the earthquake. Nevertheless, uncertainty on the equity markets – as measured by the VIX volatility index – fell back appreciably from mid-March (cf. chart 2.3). On the foreign exchange markets, the US dollar remained weak. The euro at first continued to appreciate in trade-weighted terms, but lost ground in May when the problems on the European government bond markets flared up again (cf. chart 2.4). This development coincided with Portugal having to be granted further financial assistance from the EU and the IMF, as well as the uncertainty created by talk of a restructuring of Greece's sovereign debt. Concerns among major commodity consumers about a slowdown in the economy as well as positive harvest prospects are likely to have contributed to a flattening of the price surge on the commodity markets (cf. chart 2.5).

Chart 2.1
Global industrial production

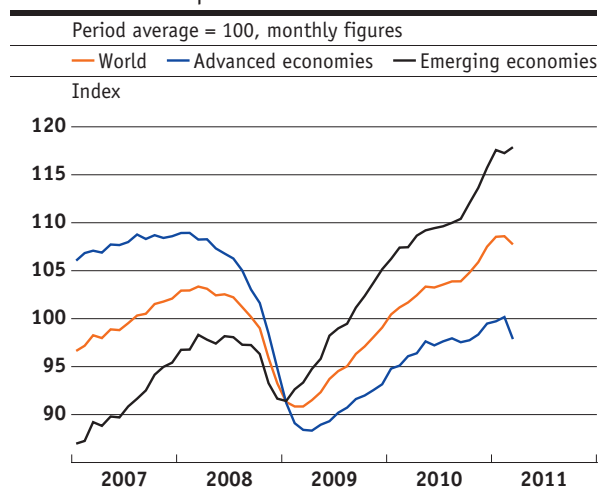


Chart 2.2
Global exports

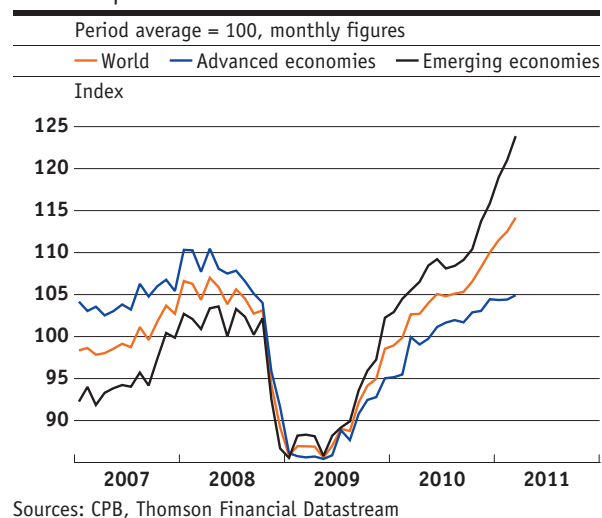
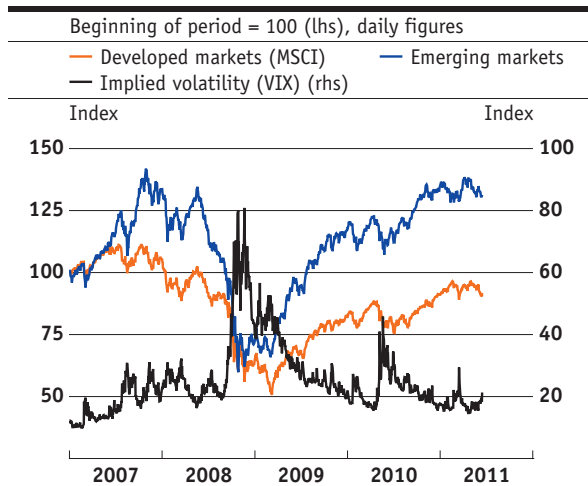
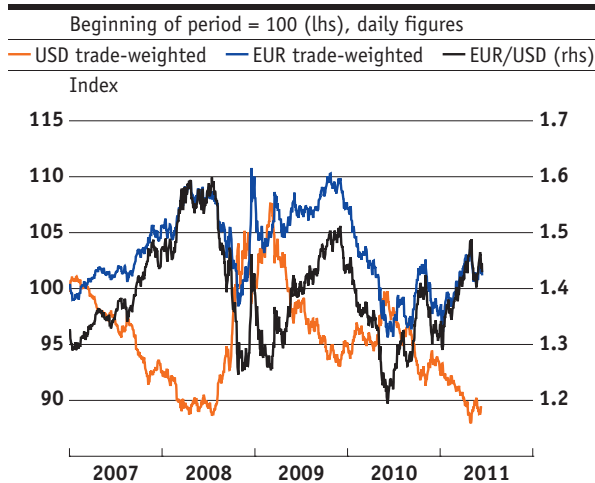


Chart 2.3
Stock markets



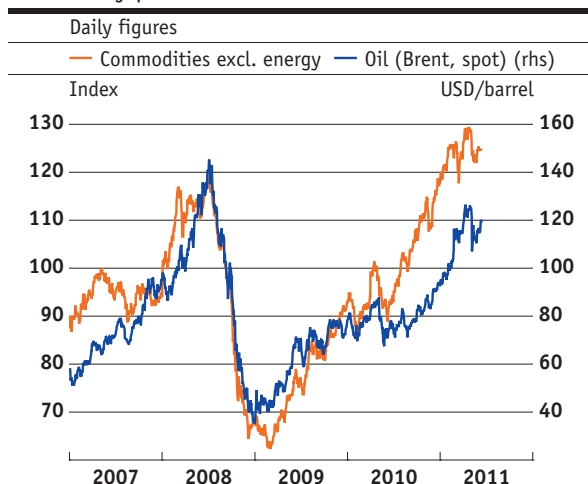
Sources: Reuters, Thomson Financial Datastream

Chart 2.4
Exchange rates



Sources: Reuters, Thomson Financial Datastream

Chart 2.5
Commodity prices



Sources: Reuters, Thomson Financial Datastream

For its forecasts, the SNB assumes an oil price of USD 118 per barrel of Brent crude and a US dollar/euro exchange rate of 1.42 USD/EUR. Compared to the March assumptions, the oil price is thus USD 21 higher, while the exchange rate reflects a weaker US dollar.

2.2 United States

The US economy continued to grow, albeit more weakly. GDP grew by only 1.8% in the first quarter. Growth was held back by the sharp increase in petrol prices and by temporary factors such as bad weather and low defence spending.

Economic indicators suggest a low rate of growth for the second quarter, too. Although higher commodity prices have resulted in a slight downward revision of growth prospects compared to March, the US economy is likely to grow more rapidly again in the second half of the year. The main indications that the underlying momentum of economic activity is solid are the gradual recovery in employment, easier access to credit and the positive corporate earnings situation. Furthermore, the export industry is reaping the benefits of the weak US dollar. Meanwhile, in addition to higher commodity prices, the persistently subdued state of the housing market is also holding back growth. Fiscal policy stimuli are gradually wearing off. In addition, fiscal consolidation measures are currently under discussion; these could hold back domestic demand in the medium term. Against this background, the SNB has adjusted its 2011 growth forecast for the US downwards from 3.2% to 2.7%. For 2012 it anticipates a growth rate of 3.3%.

Consumer price inflation in the US has increased considerably since the end of 2010. A steep rise in petrol prices drove annual inflation up to 3.6% in May. Core inflation has remained modest, but has nonetheless also risen slightly to 1.5% owing to higher rents and vehicle prices. Inflation expectations remain firmly anchored and are likely to keep inflationary pressure low in the medium term, especially since unemployment is still high.

The US Federal Reserve has maintained its expansionary monetary policy. It has left the target range for the federal funds rate unchanged at 0.0–0.25%. The second major securities programme (QE2), which provides for the purchase of US Treasury bonds to a total value of USD 600 billion, is to come to a close at end-June, as scheduled.

2.3 Euro area

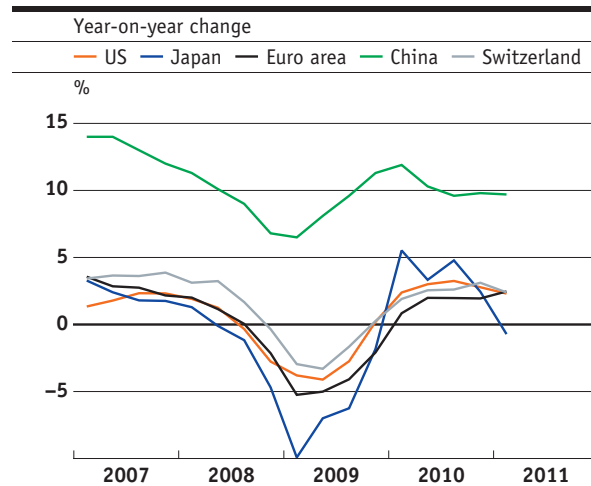
Unlike in the US, the economic recovery in the euro area has strengthened. GDP grew by 3.4% in the first quarter, having registered only weak growth in the previous quarter (owing in part to unfavourable weather conditions). Growth was underpinned by strong investment and export demand. Growth rates within the euro area still varied considerably, however. While the heavyweights of Europe – Germany and France – plus the Netherlands, Belgium and Austria recorded above-average GDP growth, the countries with high fiscal consolidation needs managed only modest growth rates. In Portugal, GDP even fell quarter-on-quarter.

Leading indicators suggest that growth in most countries of the euro area is decelerating somewhat. Business sentiment has waned in recent months. In addition, new orders are down, pointing to a slackening of the pace of industrial production. Private consumption remains vulnerable, especially since high unemployment is putting pressure on household income. Then there are the growth-inhibiting effects of the strong euro as well as higher oil prices and key interest rates. Owing to the robust growth at the start of the year, however, the SNB has raised its forecast for 2011 from 1.9% to 2.1%. Meanwhile, its 2012 growth forecast has been revised downwards by 0.4 percentage points to 2.0%.

Consumer price inflation has risen further. It reached 2.7% in May. The recent increase can be attributed to all of the major product groups, with the exception of energy. Core inflation thus rose to 1.5%.

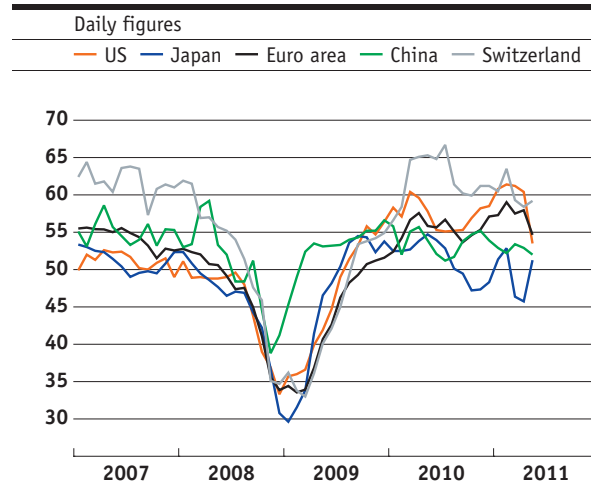
The European Central Bank (ECB) increased its main refinancing rate by 25 basis points in April, after leaving it unchanged at 1.0% for almost two years. The interest rate decision was taken against the background of the prospect of higher inflation. Since the end of March, the ECB has discontinued its purchases of securities under its Securities Market Programme, which it had begun in May 2010. At present, the markets are expecting another interest rate increase in July.

Chart 2.6
Real GDP



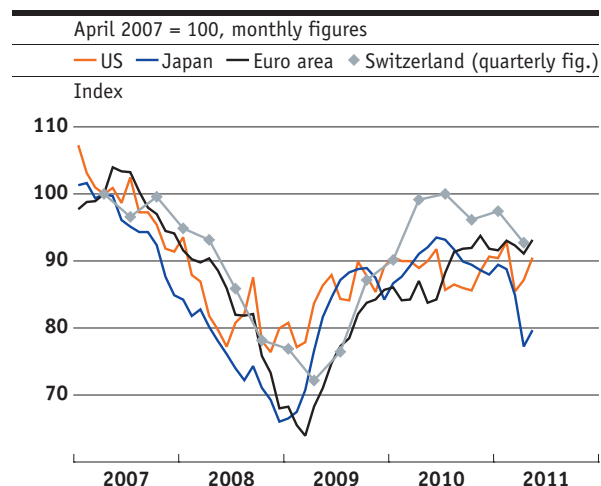
Sources: State Secretariat for Economic Affairs (SECO), Thomson Financial Datastream

Chart 2.7
Purchasing managers' indices (manufacturing)



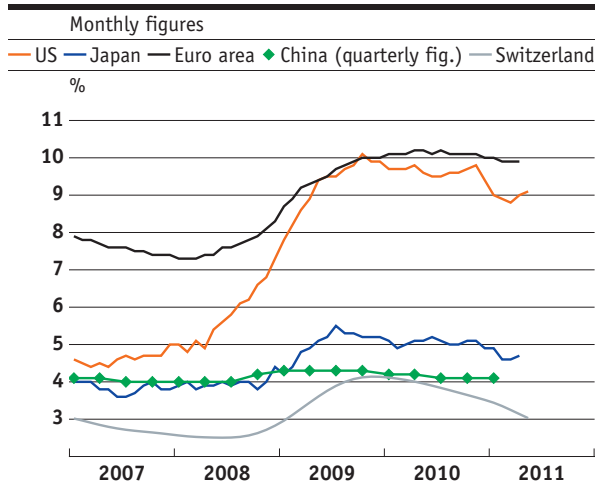
Source: Thomson Financial Datastream; copyright and database rights: Markit Economics Ltd 2009; all rights reserved

Chart 2.8
Consumer confidence index



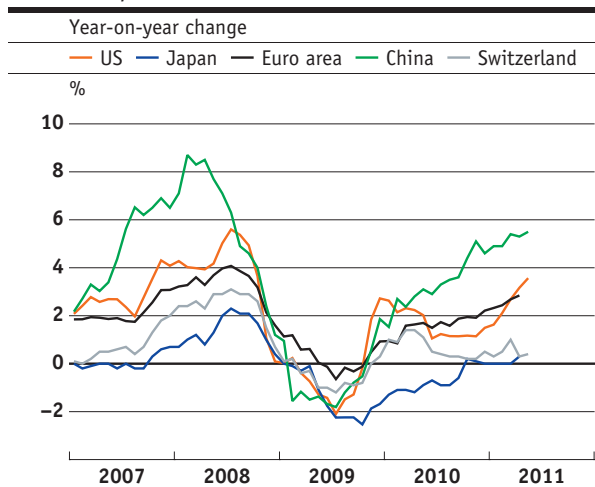
Sources: SECO, Thomson Financial Datastream

Chart 2.9
Unemployment rates



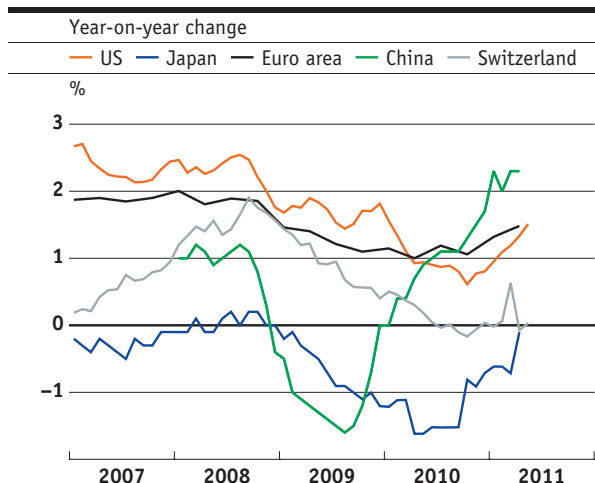
Sources: SECO, Thomson Financial Datastream

Chart 2.10
Consumer prices



Sources: Swiss Federal Statistical Office (SFSO), Thomson Financial Datastream

Chart 2.11
Core inflation rates



Sources: SFSO, Thomson Financial Datastream

2.4 Japan

The economic impact of the earthquake in Japan still remains uncertain. Initial estimates suggest that, in terms of lost output, it is likely to be one of the most costly natural disasters ever. The immediate economic impact was reflected in a widespread and severe decline in business sentiment and activity in March and April. Production constraints due to power shortages led to a sharp rundown in inventories. The outcome for the first quarter was thus a contraction in GDP of 3.5%.

Output is likely to bottom out in the second quarter. Industry indicators suggest that the backlog-clearing process has already begun. Although business sentiment has recovered, it has not returned to the optimism prevailing before the earthquake. Reconstruction activity should trigger a surge of investment from the second half of the year, thereby stimulating the Japanese economy. The Japanese government has enacted a first supplementary budget of JPY 4,000 billion (approx. 0.8% of GDP) for the reconstruction, and is planning a second supplementary budget. As a result of the contraction of GDP in the first quarter and substantial data revisions for 2010, the SNB has amended its growth forecast for Japan significantly. It is now expecting Japanese GDP to contract by 0.5% in 2011, but to grow in 2012 by 3.5%.

Japanese consumer prices are still under downward pressure. Owing largely to an increase in volatile components, inflation recently moved into positive territory.

In addition to the measures it took immediately after the natural disaster, the Bank of Japan introduced a special credit facility of JPY 1,000 billion to support financial institutions in the regions hit by the crisis and also extended an existing credit facility aimed at promoting promising investment projects by JPY 500 billion. It left the call money rate unchanged at 0.0–0.1%.

2.5 Emerging economies in Asia

The robust upturn in the emerging economies of Asia continued in the first quarter. China's GDP grew by 9.7% year-on-year (cf. chart 2.6). Economic data paint a picture of a rapidly expanding economy in which – thanks to government incentives and rising household incomes – consumer demand is gradually gaining in importance, and is supplementing investment as a driver of growth. The purchasing managers' index suggests somewhat weaker growth in the manufacturing industry in the second quarter (cf. chart 2.7). This weakening is probably due in part to events in Japan. Indicators for domestic and foreign demand, however, still show solid growth momentum overall. The SNB expects China's GDP to increase by around 10% for 2011, following a similar rate of growth last year.

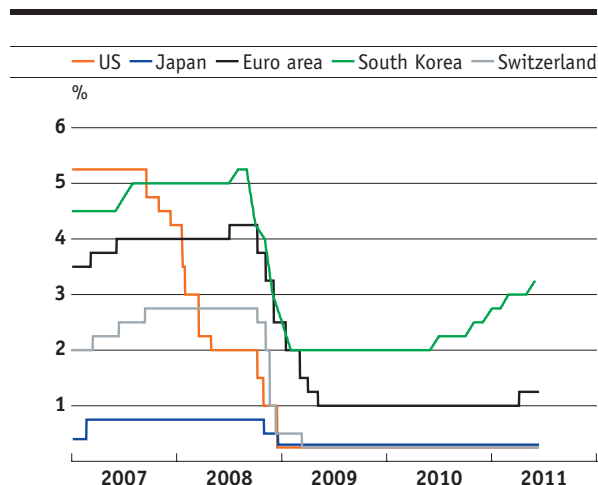
The economic situation remained very dynamic in South Korea, Taiwan, Hong Kong and Singapore, too. The aggregate GDP of these four economies expanded at a double-digit rate in the first quarter of 2011, after growth had temporarily fallen short of estimated growth potential. Growth is, however, likely to be significantly less strong in the second quarter as a result of the earthquake in Japan and its knock-on effects. The first signs of a negative economic impact in the region appeared in industrial production and trade flows in April.

Business sentiment, by contrast, remained good. For the four economies, the SNB expects growth for 2011 to be roughly in line with average growth over the last ten years.

Inflationary pressure in the region is growing. China's consumer prices rose by 5.5% year-on-year in May, well in excess of the upper limit of 4% envisaged by the government for 2011. The rise is due in part to food and energy prices, although core inflation increased as well. In South Korea, too, inflation is above the central bank's target range.

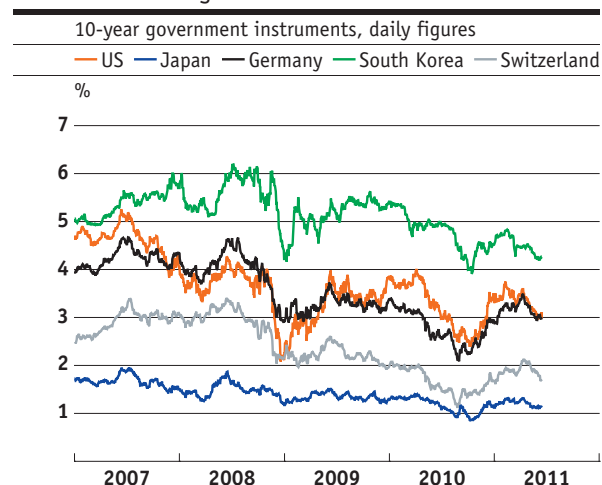
The monetary policy normalisation process in Asia is continuing. The People's Bank of China tightened minimum reserve requirements for banks and again raised key rates. It also allowed the renminbi to appreciate slightly in trade-weighted terms. The central banks of the other four economies also tightened their monetary policy. In addition to increasing inflationary pressure, the main focus of attention there is the rapid rise in real estate prices.

Chart 2.12
Official interest rates



Sources: SNB, Thomson Financial Datastream

Chart 2.13
International long-term interest rates



Sources: SNB, Thomson Financial Datastream

3 Economic developments in Switzerland

According to the SECO estimate, the growth of real GDP in Switzerland slowed in the first quarter, mainly because of the muted advance in private consumption and equipment investment as well as a negative contribution from inventories. By contrast, exports recorded a marked gain as a result of robust international demand, particularly from Germany and Asia, despite the strength of the Swiss franc. The strong momentum in construction also supported growth.

Utilisation of technical capacity continued to pick up and was above the long-term average in manufacturing; in the construction sector it actually attained a record high level. The recovery on the labour market also continued. After a massive increase during the crisis, measures introducing short-term work have largely been retracted. In May, the seasonally-adjusted unemployment ratio decreased to 3.0% and companies are reporting more difficulties in recruiting qualified employees.

Due to the appreciation of the Swiss franc, export-gearred companies are exposed to strong price competition. In manufacturing, in particular, margins are under very strong pressure in some cases. However, survey results still suggest that robust foreign demand allows for good utilisation of capacities and supports exports. The short-term outlook remains good for domestic demand. Construction investment is benefiting from favourable

financing conditions, while higher capacity utilisation should stimulate equipment investment. Demand for labour is likely to firm further. For 2011, the SNB is maintaining its forecast of real GDP growth amounting to around 2%.

3.1 Aggregate demand and output

Weak growth in added value

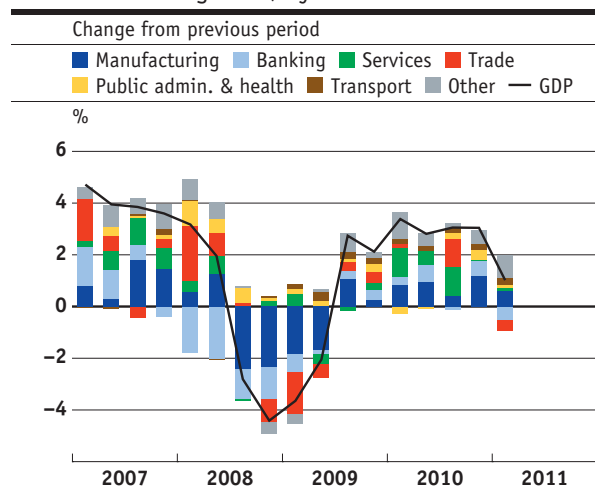
According to provisional estimates by the State Secretariat for Economic Affairs (SECO), GDP growth in the first quarter weakened to 1.0%, compared to a rate of 3.0% in the previous quarter. The year-on-year change in the first quarter was 2.4%. The slowdown was thus more pronounced than suggested by many indicators. On the output side, most sectors lost momentum (cf. chart 3.1). Worst hit was the banking sector, whose value added fell by 7.4%. Value added also fell in the trading and hospitality industries. By contrast, the insurance, construction and manufacturing industries continued to make a considerable contribution to growth.

Stagnating domestic final demand

Growth in domestic final demand came to a standstill in the first quarter (cf. chart 3.2 and table 3.1).

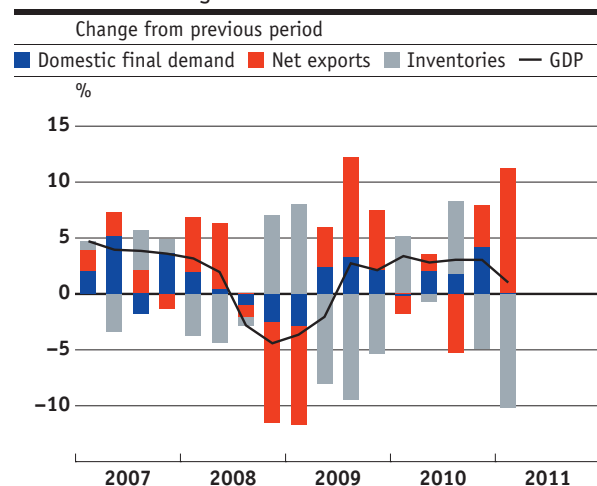
Growth in private consumption remained modest. According to the quarterly SECO survey, consumer confidence also dipped slightly in April.

Chart 3.1
Contributions to growth, by sector



Source: SECO

Chart 3.2
Contributions to growth in demand

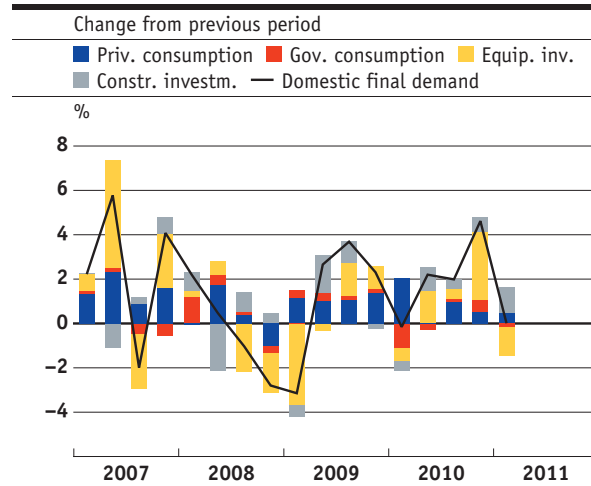


Source: SECO

Equipment investment fell by 10.3%, but this was after exceptionally high growth in the previous quarter. In a year-on-year comparison, it continued to rise strongly. Investment in software and communications technology showed a particularly large increase, and investment in machinery was also significantly higher than the year-back level.

Construction investment exceeded the previous high point of the mid-1990s. According to the surveys conducted by the Swiss Federation of Master Builders (SBV/SSE), civil engineering reported a particularly strong rise in turnover. Residential construction also continued to grow strongly, driven by low interest rates and immigration. Unusually mild temperatures in the winter months provided additional support.

Chart 3.3
Domestic final demand, growth contributions



Real GDP and components

Growth rates on previous period, annualised

Table 3.1

| | 2007 | 2008 | 2009 | 2010 | 2009 | | | 2010 | | | | 2011 |
|------------------------------|------------|------------|-------------|------------|-------------|-------------|-------------|-------------|------------|-------------|------------|--------------|
| | | | | | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 |
| Private consumption | 2.3 | 1.3 | 1.0 | 1.7 | 1.5 | 1.6 | 2.1 | 3.2 | 0.1 | 1.5 | 0.8 | 0.7 |
| Government consumption | 0.3 | 1.7 | 1.6 | -1.6 | 3.1 | 1.5 | 1.6 | -8.7 | -2.3 | 1.4 | 4.6 | -1.3 |
| Investment in fixed assets | 5.1 | 0.5 | -4.9 | 4.6 | 5.7 | 11.1 | 3.3 | -4.5 | 11.2 | 3.8 | 15.9 | -1.0 |
| Construction | -2.3 | 0.0 | 3.0 | 3.3 | 16.4 | 9.4 | -2.5 | -4.0 | 10.5 | 3.9 | 6.1 | 11.1 |
| Equipment | 11.1 | 0.8 | -10.8 | 5.7 | -2.7 | 12.6 | 8.5 | -4.9 | 11.8 | 3.7 | 24.7 | -10.3 |
| Domestic final demand | 2.7 | 1.2 | -0.3 | 2.0 | 2.7 | 3.7 | 2.3 | -0.2 | 2.2 | 2.0 | 4.6 | 0.0 |
| Domestic demand | 1.4 | 0.2 | 0.6 | 0.6 | -7.3 | -6.6 | -1.3 | 2.1 | 0.8 | 11.7 | 1.4 | -11.9 |
| Total exports | 9.6 | 3.3 | -8.7 | 9.3 | -6.9 | 33.1 | 13.1 | 6.3 | 16.9 | -9.6 | 5.9 | 24.7 |
| Goods ¹ | 8.3 | 2.1 | -11.1 | 9.3 | -2.5 | 19.0 | 13.4 | 11.0 | 4.0 | 2.3 | 15.5 | 12.9 |
| Services | 12.8 | 4.8 | -2.0 | 6.5 | -14.2 | 58.7 | 21.4 | -22.2 | 54.2 | -23.4 | -7.6 | 51.0 |
| Aggregate demand | 4.4 | 1.4 | -3.0 | 3.8 | -7.1 | 6.3 | 4.0 | 3.7 | 6.8 | 2.9 | 3.1 | 0.9 |
| Total imports | 6.1 | 0.3 | -5.4 | 6.8 | -17.9 | 15.0 | 8.3 | 4.7 | 16.9 | 2.5 | 3.3 | 0.6 |
| Goods ¹ | 6.7 | -1.0 | -8.5 | 9.9 | -22.1 | 23.5 | 1.6 | 18.8 | 17.5 | 3.7 | 5.2 | 2.8 |
| Services | 11.2 | 3.9 | 8.1 | -4.5 | 5.9 | -8.5 | 30.9 | -40.8 | 30.2 | 3.2 | -16.7 | 4.3 |
| GDP | 3.6 | 1.9 | -1.9 | 2.6 | -2.1 | 2.7 | 2.1 | 3.4 | 2.8 | 3.1 | 3.0 | 1.0 |

1 Goods: excluding valuables (precious metals, precious stones and gems as well as works of art and antiques)

Source: SECO

Large external contribution due to strong growth in exports

At more than 10 percentage points, foreign trade made an exceptionally large contribution to demand growth in the first quarter. Following the moderate increase in the previous quarter, growth in exports of goods and services was exceptionally strong (cf. chart 3.4). Imports, by contrast, recorded only moderate growth.

Exports of goods expanded on a broad front in the first quarter, benefiting from robust global manufacturing growth. Although exports of chemicals and pharmaceuticals grew less strongly than in the previous quarter, the exports of many other important industries (machines, metals, precision instruments, watches and jewellery) increased appreciably. A breakdown by sales markets reveals that growth was also broad based. Exports to the emerging Asian economies continued to expand strongly. In addition, exports to Europe, the US and to oil-exporting countries recovered. Exports to Japan also registered an increase.

Following a decline in the previous two quarters, exports of services expanded massively in the

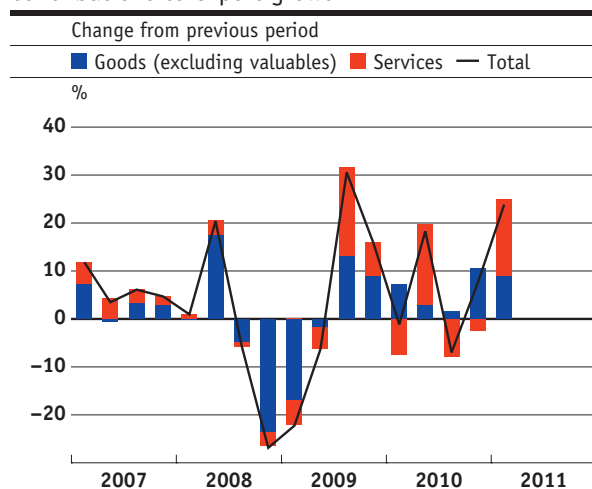
first quarter. Although tourism exports fell slightly again, growth in exports of other services was exceptionally strong. These include not only earnings from cross-border banking operations and exports of insurance services, but also, in particular, net revenues from merchanting. In view of the higher commodity prices, the latter made a significant contribution to the sharp increase in exports of services.

Imports rose only slightly in the first quarter, with imports of both goods and services recording positive growth rates (cf. chart 3.5).

Although imports of consumer goods and energy sources declined, imports of intermediate and semi-finished products increased appreciably. In addition to imports of machines (particularly for the manufacturing industry), there was also a marked rise in imports of motor vehicles and building materials.

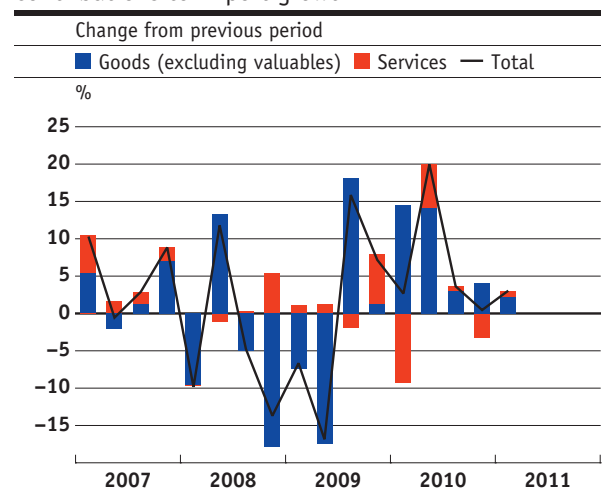
As regards services, consumer spending by Swiss residents when abroad (which is recorded under tourism imports) increased, as did imports of other services (mainly spending on licence and patent fees abroad).

Chart 3.4
Contributions to export growth



Source: SECO

Chart 3.5
Contributions to import growth



Source: SECO

3.2 Labour market

Rise in employment

Seasonally adjusted, around 21,500 new jobs were created in Switzerland in the first quarter, which represents growth of 2.1% (cf. chart 3.6). The main contribution to this appreciable growth came from part-time jobs, the number of which has, however, risen because of a broader definition of part-time employment. Growth in full-time employment was, by contrast, more moderate (0.4%). Taking these factors into account, the volume of actual hours worked in the first quarter is likely to have risen less strongly than the number of jobs.

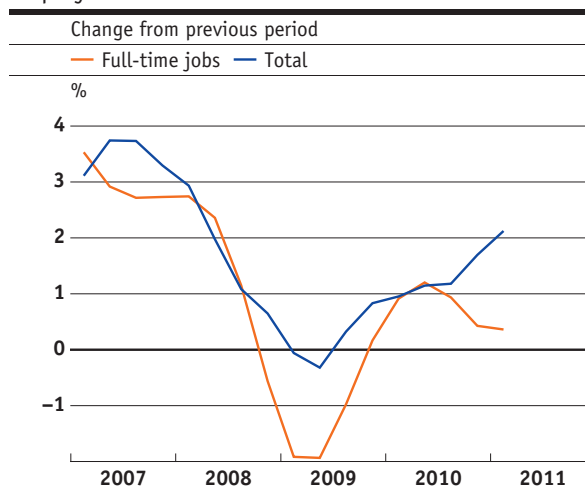
The rise in employment was particularly pronounced in the transport and warehousing industries, as well as in healthcare and social services and in other business services. In the manufacturing and construction industries, employment growth remained robust but lost a little momentum.

Significant fall in unemployment

Seasonally adjusted, unemployment fell significantly between February and May. The number of people registered as unemployed with regional employment offices decreased by 13,000 (seasonally adjusted), which represents a decline in the unemployment rate from 3.4% to 3.0% (cf. chart 3.7). During the same period, the proportion of job-seekers fell from 4.9% to 4.4%. In addition to the positive economic situation, the revision of the law on unemployment insurance in April also contributed to the fall in unemployment.

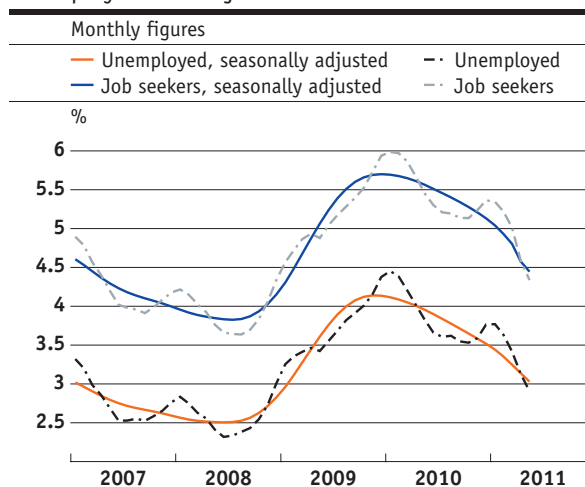
As a result of the economic recovery, short-time working decreased again (cf. chart 3.8). In March, 5,300 people were still affected by short-time working, as compared to the peak of 92,300 people registered during the recession.

Chart 3.6
Employment



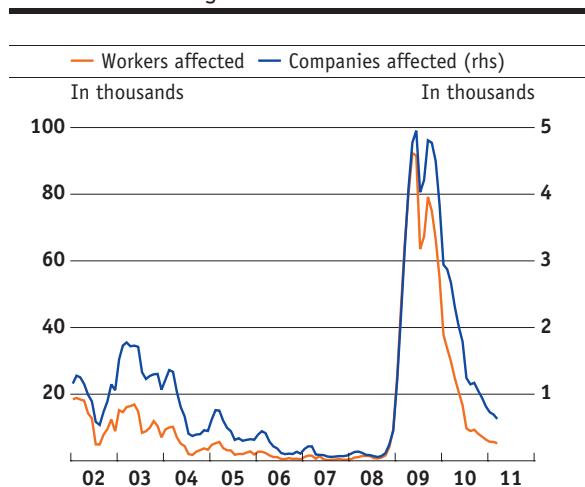
Source: SFSO, seasonal adjustment: SNB

Chart 3.7
Unemployment and job seeker rates



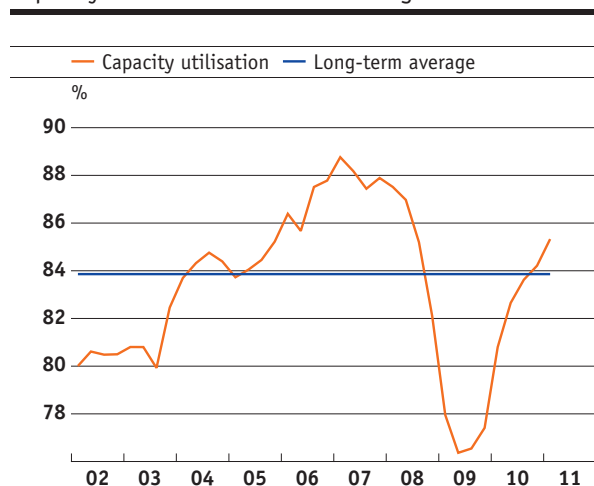
Unemployed and job seekers registered with the regional employment offices, as a percentage of the labour force according to the 2000 census (labour force: 3,946,988 persons).
Source: SECO

Chart 3.8
Short-time working



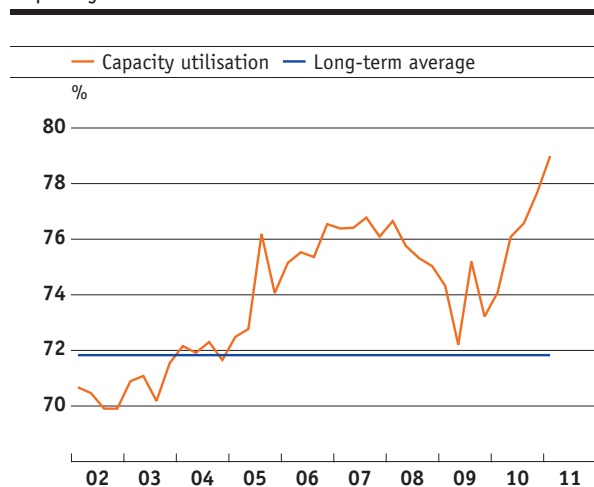
Source: SECO

Chart 3.9
Capacity utilisation in manufacturing



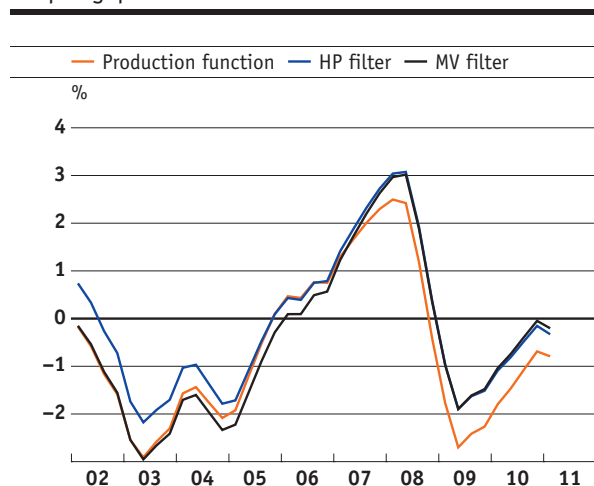
Source: KOF Swiss Economic Institute

Chart 3.10
Capacity utilisation in construction



Source: KOF Swiss Economic Institute

Chart 3.11
Output gap



Source: SNB

3.3 Capacity utilisation

Increase in capacity utilisation

Technical capacity utilisation increased further in the first quarter. According to the KOF Swiss Economic Institute (KOF) survey, capacity utilisation in manufacturing was above its long-term average, at 85.3% (cf. chart 3.9). The number of businesses complaining of a shortage of labour and technical capacity is correspondingly high.

Utilisation in the construction sector is exceptionally high. The level of machine utilisation reached a new peak of 79.0% in the first quarter (cf. chart 3.10). Accordingly, many of the businesses surveyed by KOF are complaining about bottlenecks in machinery and equipment capacity.

The KOF survey reveals that capacity utilisation among service companies is average. Employment is currently described by the businesses surveyed as satisfactory.

Output gap almost closed

How well the production factors in an economy are being utilised is indicated by the output gap, which is defined as the percentage deviation of GDP from estimated aggregate potential output.

Estimates of potential output using different methods all indicate that, in the first quarter, GDP was still slightly below potential (cf. chart 3.11). Depending on the method used, the output gap was -0.8% (production function), -0.3% (Hodrick-Prescott filter) or -0.2% (multivariate filter). Surveys indicated that technical capacity was well utilised in the first quarter. Consequently, the estimate of the output gap based on the production function method implies a slight underutilisation of labour force potential.

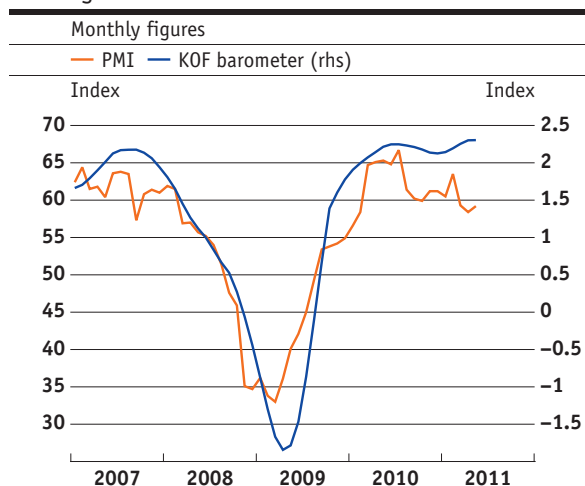
3.4 Outlook for the real economy

The SNB expects the economic recovery to continue, albeit at a less pronounced pace than in 2010. The positive trend in exports in the last two quarters should not hide the fact that exporting companies are facing strong price competition. In manufacturing, in particular, some margins are under very strong pressure. That notwithstanding, the survey results continue to indicate that strong foreign demand is keeping capacity utilisation at a good level and supporting exports.

The short-term outlook remains good for domestic demand. Construction investment is benefiting from favourable financing conditions, while higher capacity utilisation should stimulate equipment investment.

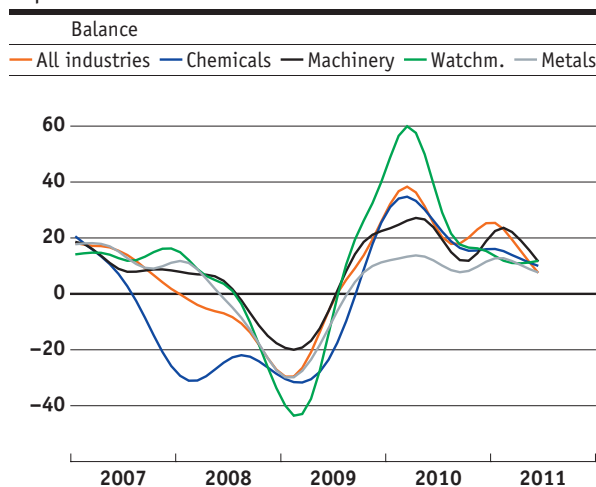
The positive trend in demand for labour is likely to bring about a decline in the unemployment rate. For 2011, the SNB is maintaining its forecast of real GDP growth amounting to around 2%.

Chart 3.12
Leading indicators



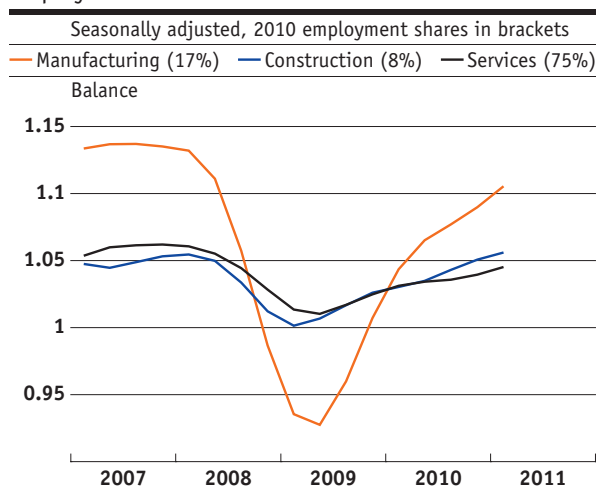
Sources: Credit Suisse, KOF Swiss Economic Institute

Chart 3.13
Expected new orders



Source: KOF Swiss Economic Institute

Chart 3.14
Employment outlook indicator



Source: SFSO, seasonal adjustment: SNB

4 Prices and inflation expectations

At consumer level, inflation has remained low over the past few months. A temporary increase in the year-on-year rate in March is essentially attributable to a one-off statistical effect due to more frequent surveys of prices for clothing and shoes. Although the total supply price index (producer and import prices) rose between February and May, the year-on-year rate declined due to a base effect, even dropping into negative territory towards the end of the period. However, surveys on price expectations suggest that the inflation expectations of households and companies have risen slightly.

4.1 Consumer prices

Temporary rise in CPI inflation in March

The annual inflation rate as measured by the national consumer price index (CPI) temporarily rose in March to 1.0%, before falling back in April (0.3%) and May (0.4%) to the same level as in previous months (table 4.1). The reason for the sharp blip in March was the decision taken as part of the revision of the CPI in 2010 to increase the survey frequency for clothing and shoes. As a result of this adjustment, the sales clearance prices recorded for January 2011 were no longer carried through to the following two months, as had previously been the case. This had a one-off statistical impact on the annual inflation rate, as the prices of clothing and shoes registered in March 2011 were effectively compared with the sales clearance prices of January 2010. This statistical effect is likely to recur in the third quarter of 2011.

National consumer price index and components
Year-on-year change in percent

Table 4.1

| | 2010 | 2010 | | | 2011 | 2011 | | |
|----------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | | Q2 | Q3 | Q4 | Q1 | March | April | May |
| Overall CPI | 0.7 | 1.0 | 0.3 | 0.3 | 0.6 | 1.0 | 0.3 | 0.4 |
| Domestic goods and services | 0.6 | 0.6 | 0.4 | 0.5 | 0.6 | 0.7 | 0.5 | 0.6 |
| Goods | -0.1 | 0.0 | -0.4 | -0.5 | -1.0 | -0.9 | -1.6 | -0.9 |
| Services | 0.8 | 0.9 | 0.7 | 0.8 | 1.1 | 1.2 | 1.2 | 1.1 |
| Private services excluding rents | 0.6 | 0.7 | 0.5 | 0.4 | 0.6 | 0.7 | 0.8 | 0.8 |
| Rents | 1.1 | 1.1 | 0.9 | 1.2 | 1.5 | 1.5 | 1.5 | 1.2 |
| Public services | 0.9 | 0.8 | 0.7 | 1.2 | 2.0 | 2.0 | 1.8 | 1.8 |
| Imported goods and services | 0.9 | 1.9 | -0.1 | -0.1 | 0.5 | 1.8 | -0.5 | -0.3 |
| Excluding oil products | -1.3 | -1.2 | -1.4 | -1.5 | -1.3 | -0.1 | -2.5 | -1.8 |
| Oil products | 13.9 | 21.0 | 8.6 | 8.5 | 10.5 | 12.3 | 10.7 | 7.6 |

Source: SFSO, SNB

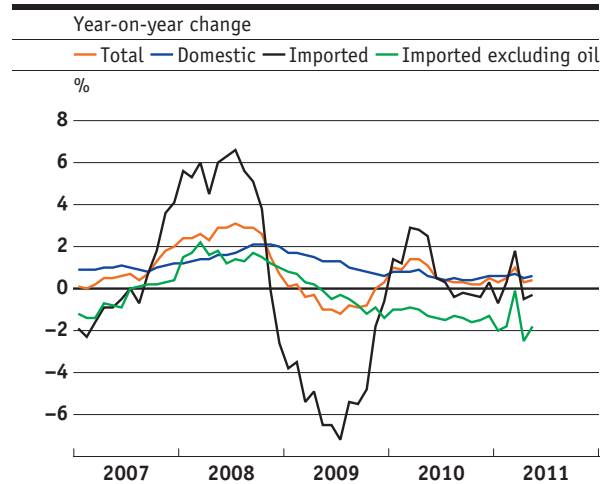
Inflation in foreign commodities, excluding oil products, still negative

Inflation rates for domestic and foreign commodities have been fairly close to one another for about a year, as prices of foreign commodities have been more stable than in previous years (cf. chart 4.1). But clear differences are discernible within these two categories. On the domestic front, annual inflation in the services field is well into positive territory, while goods prices have actually fallen in the same period (cf. chart 4.2). In the foreign category, consisting almost entirely of goods, the prices of heating oil and fuels have risen significantly in the last year, while on average those of other goods have fallen. The strong Swiss franc held down price rises in oil-based products, and was a major factor in price falls for foreign goods (excluding oil products). In April, annual inflation in oil products was some 6 percentage points lower in Switzerland than in neighbouring countries.

Moderate core inflation

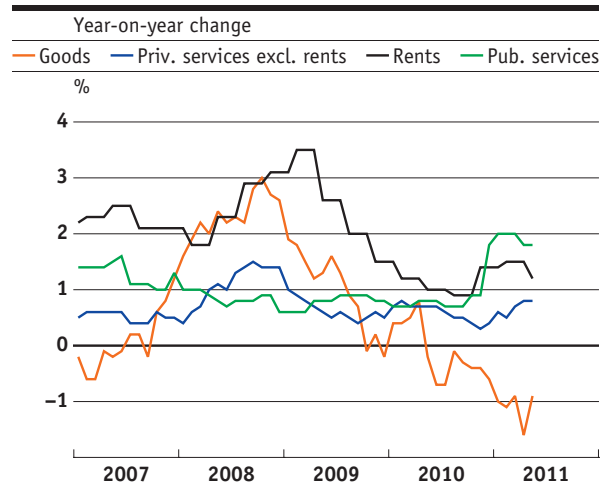
Inflation, as measured by the CPI, is subject to short-term fluctuations, which may distort perceptions of the general price trend. Estimates of core inflation are therefore useful (cf. chart 4.3). The core inflation rates calculated by the Swiss Federal Statistical Office (SFSO) exclude the same goods from the commodities basket in every period. As clothing and shoes are not among the goods excluded, the SFSO core rates are affected by the March blip triggered by the revision of 2010 in the same way as the annual CPI inflation rate. A more informative picture of changes in underlying inflation in this period is provided by the SNB's two core inflation rates, the trimmed mean (TM15) and dynamic factor inflation (DFI). In the TM15, the 15% of commodity prices with the highest and lowest annual rates of change are excluded from the CPI every month. The broader-based DFI calculates underlying inflation using an empirically estimated dynamic model that includes other real and nominal economic data as well as price data. Both measures of core inflation indicate that there has been no significant change in the underlying price trend since last February. The TM15 stood at 0.6% in May, and the DFI at 1.1%.

Chart 4.1
CPI: domestic and imported goods and services



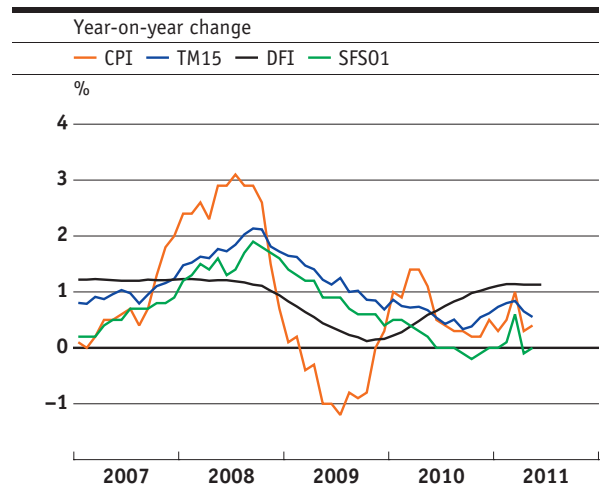
Sources: SFSO, SNB

Chart 4.2
CPI: domestic goods and services



Sources: SFSO, SNB

Chart 4.3
Core inflation rates



Sources: SFSO, SNB

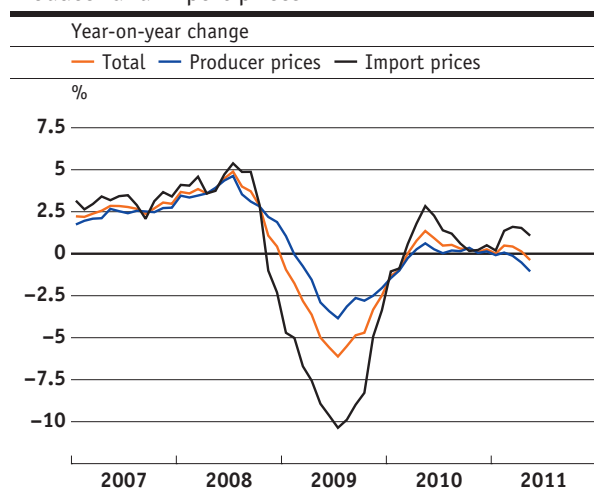
4.2 Producer and import prices

Decline in oil prices in May

The total supply price index (producer and import prices) rose between February and May by 0.5%. Since prices rose at a higher rate in the same period of the previous year, this meant that the annual inflation rate declined by 0.9 percentage points in May to -0.4% (cf. chart 4.4). Despite the decrease in oil prices at the beginning of May, prices of energy products were still substantially higher than they had been in February.

If price-volatile goods are excluded, the total supply price index has declined by 0.1% since last February. The corresponding annual inflation rate in May was also in negative territory, at -1.3%. As before, no general inflationary pressure is emanating from producer and import prices.

Chart 4.4
Producer and import prices



Source: SFSO

4.3 Real estate prices

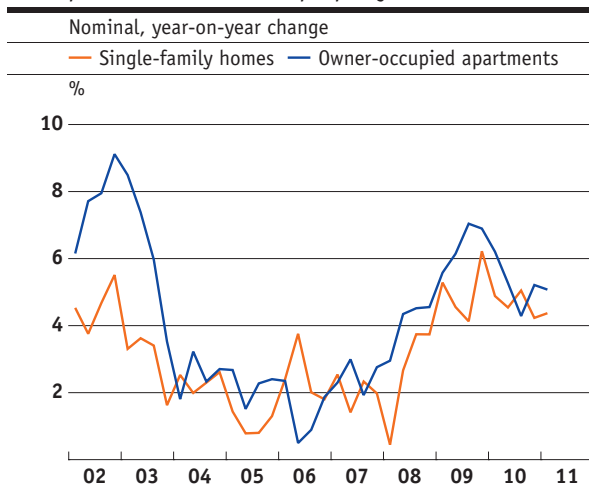
Residential property prices still rising fast

The vigorous upward trend in the prices of single-family homes and owner-occupied apartments continued in the first quarter. Asking prices were about 5% above the previous year's level (cf. chart 4.5). The actual transaction prices, particularly for owner-occupied apartments, rose strongly. Despite this strong price rise, real estate prices are currently at a level which is largely consistent with the most important fundamental factors such as income, population and construction activity. In the long term, though, real estate will not be able to go on appreciating at the same rate. The longer prices continue to rise as they have in recent years, the greater the probability of a correction, which could be sudden and drastic.

Moderate rise in apartment rents

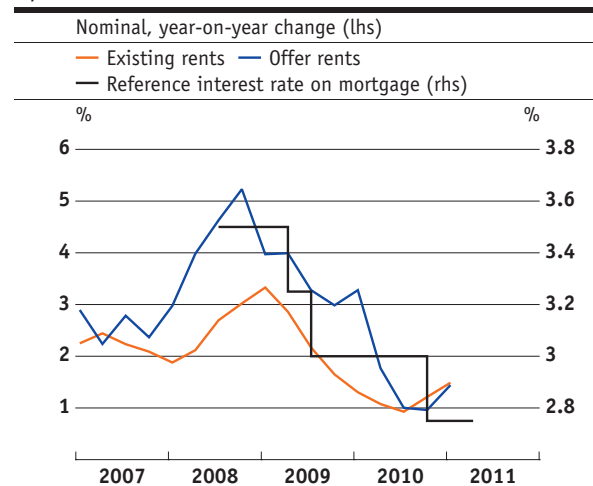
Whereas average residential property prices have risen substantially, rises in apartment rents have been moderate (cf. chart 4.6). Rents for apartments available on the market rose by 1.4% in the last year. The increase in the rental component of the national consumer price index (CPI) was of a similar order. This reflects the rents under existing tenancies, which are largely tied to the mortgage reference rate. This rate fell to 2.75% in December 2010 and has stayed there ever since.

Chart 4.5
Offer prices for residential property



Source: Wüest & Partner

Chart 4.6
Apartment rents and reference interest rate



Sources: Federal Office for Housing (FOH), SFSO, Wüest & Partner

4.4 Inflation expectations

Inflation expectations on a slight rise

The findings of surveys on expected developments in consumer prices indicate a slight rise in inflation expectations and a slightly higher degree of uncertainty.

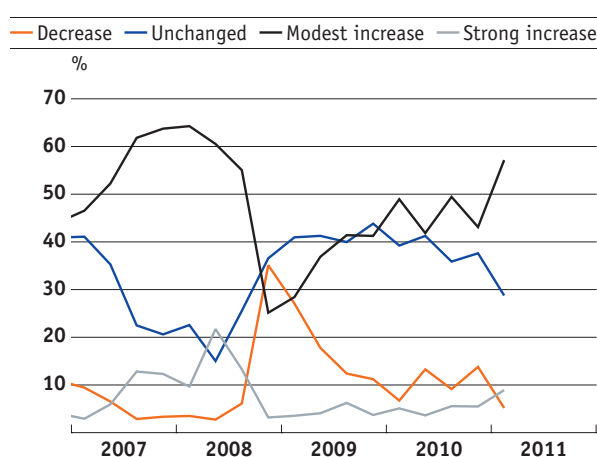
The quarterly survey of consumer confidence conducted by SECO shows that households' inflation expectations in April were rather higher than they had been in January (cf. chart 4.7). The proportions of respondents expecting prices to rise moderately or sharply in the coming twelve months both increased, while there was a decline in the number of respondents who expected unchanged or falling prices.

The monthly Credit Suisse ZEW Financial Market Report, which is based on responses from about 70 financial market experts, identified significant increases in inflation expectations in both March and April 2011. In May, however, respondents adjusted their inflation expectations slightly downwards. The decline in commodity prices at the beginning of May and the worsening of the debt crisis in Europe were probably contributory factors. Slightly more than half of all respondents in May thought CPI inflation would rise in the coming months, while 40% expected inflation rates to remain unchanged.

Purchase and sale prices expected to rise

The quarterly KOF survey asks industrial and wholesale companies how they expect purchase and sale prices to perform in the next three months. In April, most of them expected these prices to rise. Where sale prices are concerned, it is noticeable that most wholesalers have been expecting rising prices for several months, whereas among industrial respondents this view formed only recently and is less pronounced.

Chart 4.7
Survey on expected movements in prices



Sources: SECO, SNB

5 Monetary developments

Monetary conditions were again characterised by the divergence between low interest rates and the Swiss franc, which again appreciated significantly. Since the monetary policy assessment in March, the three-month Libor has persisted in the lower part of the target range. With inflation expectations rising slightly, real interest rates have remained low and even, in the short-term range, negative. In general, although long-term interest rates have risen since their low point in August 2010, they are still at a low level.

By contrast, the real export-weighted Swiss franc appreciated further in the second quarter and has reached an all-time high. By the beginning of May, the US dollar – mainly – had weakened significantly against the Swiss franc. Thereafter, renewed concerns about stability in the euro area also led to a depreciation of the euro. The SNB is concerned about exchange rate developments. The SNB forecasts are based on the premise that the exchange rate developments will stabilise in the medium term. Should the exchange rate again be subject to significant changes, a reassessment of the inflation outlook would be required.

Since the last monetary policy assessment, the M2 and M3 aggregates have been growing at about 7% year-on-year. Some of this high growth rate is attributable to the current low interest rates. Overall, ample liquidity is available in the economy and this means potential risks for price stability in the long term.

Mortgage lending has also continued to increase substantially. In an environment of low

interest rates and substantial advances in real estate prices, a high rate of growth in mortgages can harbour risks for financial stability. In view of the potential risks for the financial sector, the SNB continues to closely observe the situation on the mortgage and real estate markets.

5.1 Summary of monetary policy since the last assessment

Continuation of expansionary monetary policy

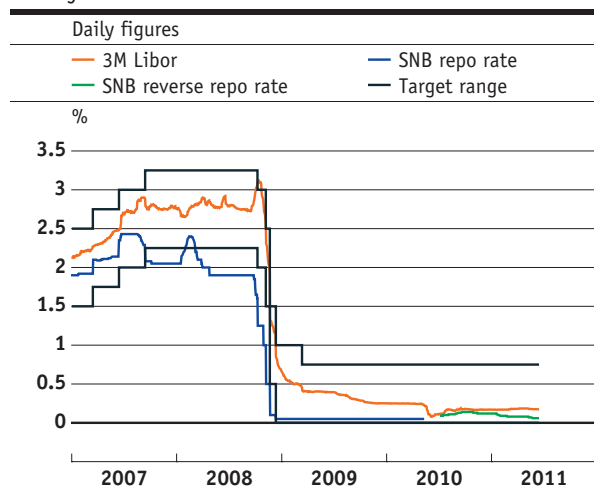
In its assessment of March 2011, the SNB decided to maintain its expansionary monetary policy. It left the target range for the three-month Libor unchanged at 0.0–0.75%, and announced that it intended to keep it within the lower part of the target range, at around 0.25%.

In the three months since the last monetary policy assessment, the SNB has kept the Libor at about 0.18%. Sight deposits with domestic banks averaged CHF 24 billion, some CHF 3 billion less than in the preceding period – i.e. the period between the assessments conducted in December 2010 and March 2011. The SNB continued to utilise SNB Bills and liquidity-absorbing repo transactions to manage liquidity in the Swiss franc market.

Unchanged volume of liquidity-absorbing repo transactions

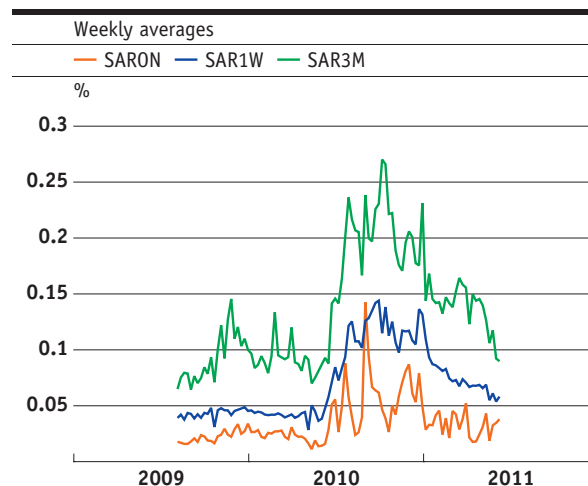
The volume of liquidity-absorbing repo transactions averaged CHF 25 billion, roughly the same as in the preceding period. Auctions were conducted daily during the period under review. The term of the repo

Chart 5.1
Money market rates



Sources: Reuters, SNB

Chart 5.2
Swiss Reference Rates



Source: SIX Swiss Exchange Ltd

transactions was usually one week. The repo rate for these auctions was reduced from 0.08% to 0.07% on 10 May, and from 0.07% to 0.06% on 23 May. Bids from financial market participants averaged CHF 56 billion, and the SNB's acceptance rate since mid-March has averaged 9.4%.

Decline in holdings of SNB Bills

Holdings of SNB Bills were reduced by CHF 5 billion to CHF 111 billion between March and June 2011. Issues took place weekly. Two different terms were available for each issue: one of 28 days, the other alternating between 84, 168 and 336 days. Market yields were between 0.07% and 0.39%. The SNB allocated an average of 62.5% of the SNB Bills applied for. The average residual term of the entire holding of SNB Bills rose from 74 to 80 days.

Slight fall in the banks' surplus reserves

Statutory minimum reserves averaged CHF 9.8 billion between 20 February and 19 May 2011. They were thus practically unchanged from the preceding period (20 November 2010 to 19 February 2011). On average, banks exceeded the requirement by around CHF 20.2 billion (previous period: CHF 22.6 billion). The average compliance level fell from 331% to 306%.

5.2 Money and capital market interest rates

Money market rates still low

Interest rates on unsecured money market investments remained largely unchanged between the assessments conducted in mid-March and mid-June (cf. chart 5.1). Money market rates for secured investments, by contrast, continued the gentle decline that began in November 2010. The weekly average of the three-month SAR (Swiss Average Rate) fell from 0.16% in mid-March to 0.09% in June (cf. chart 5.2).

Correction in longer-term interest rates

Medium and long-term interest rates, which had staged a significant recovery since the summer of 2010, continued to rise until the beginning of April but then fell back. The yield on ten-year Swiss Confederation bonds, for example, rose from 1.8% in mid-March to 2.1% at the beginning of April, before declining to 1.7% in mid-June. Even so, yields remained substantially higher than the low levels recorded in August 2010 (1.1%).

Yields on corporate bonds with high credit ratings moved in parallel with those of government bonds. Yield premiums on lower-rated corporate bonds declined, however, reflecting a similar development abroad.

Chart 5.3
Term structure of Swiss Confederation bonds

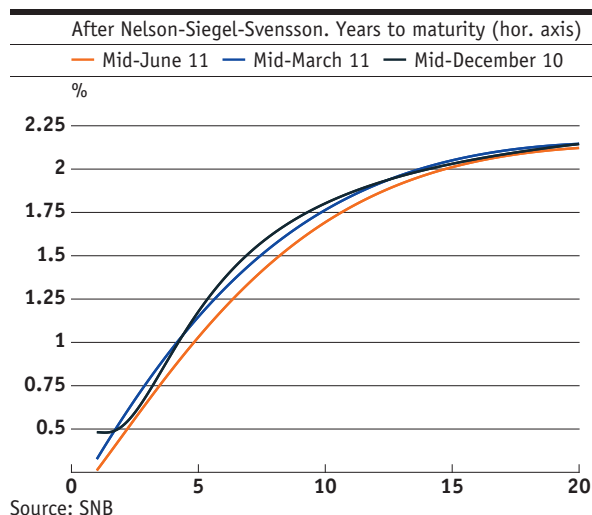


Chart 5.4
Estimated real interest rate



Yield curve shifts downwards

As a result of the movements in both short and long-term interest rates, the yield curve in mid-June lay slightly below the curve for mid-March (cf. chart 5.3). There was also a slight contraction in the difference between the yield on ten-year Confederation bonds and the three-month Libor. This stood at 1.5 percentage points in mid-June, as against 1.6 percentage points in mid-March and a historical average of 1.3 percentage points since the mid-1990s.

Stimulating real interest rates

The estimated three-year real interest rate remains at a low level, supporting both consumer and investment demand. In the second quarter of 2011, it stood at 0.0% (cf. chart 5.4). It had risen slightly over the previous quarter, as the nominal interest rate was marginally up while inflation expectations were largely unchanged. This estimate of inflation expectations is based on inflation forecasts generated by various SNB models.

5.3 Exchange rates

Appreciation of the Swiss franc

Since the monetary policy assessment of March 2011, the Swiss franc has appreciated against both the US dollar and the euro (cf. chart 5.5). The euro is currently suffering – as it has done in previous phases – from concerns about stability in the euro area.

More restrictive monetary conditions

The Swiss franc's rise in the foreign exchange markets has exacerbated monetary conditions. The Monetary Conditions Index (MCI) shown in chart 5.6 quantifies changes in monetary conditions by combining changes in the three-month Libor and in the nominal trade-weighted external value of the Swiss franc. In order to take account of uncertainty regarding the relative impact of changes in interest rates and exchange rates, two weightings are used for the MCI (3:1 and 5:1). The index is reset to zero immediately after each monetary policy assessment. A higher value is an indication of more restrictive monetary conditions. As there has been no change in short-term interest rates, the rise in the MCI is solely attributable to the strengthening of the Swiss franc.

Chart 5.5
Exchange rates

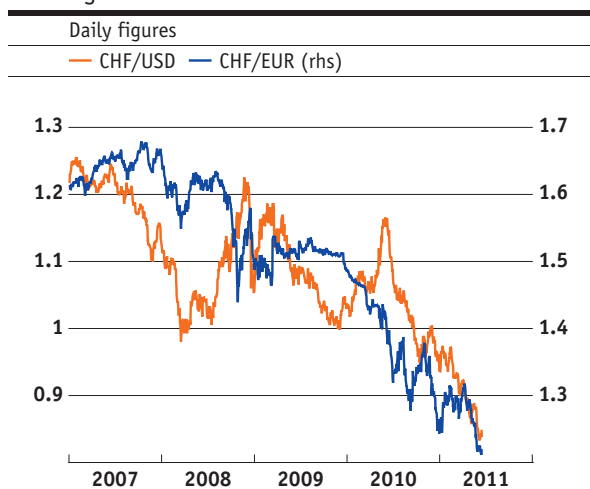


Chart 5.6
MCI nominal

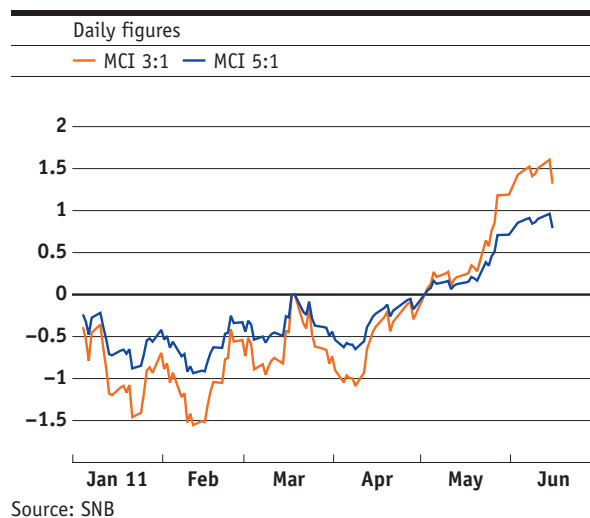
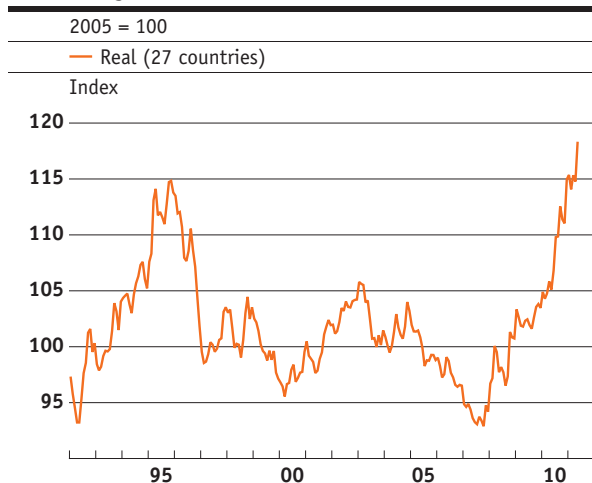
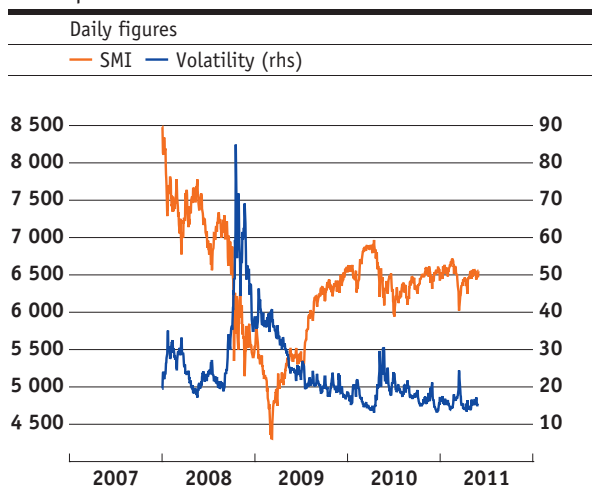


Chart 5.7
Trade-weighted external value of Swiss franc



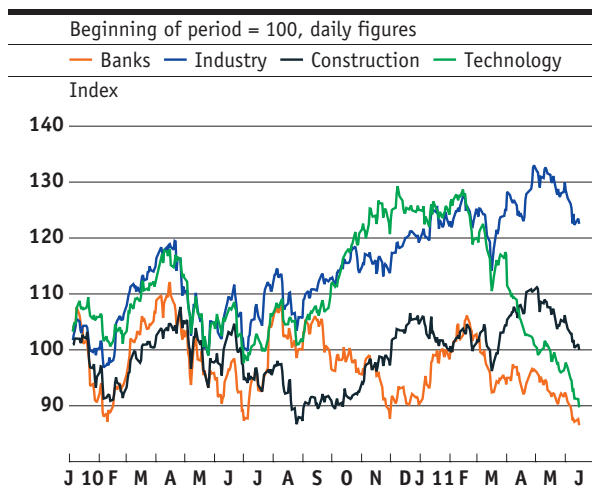
Source: Bank for International Settlements

Chart 5.8
Share prices



Source: Thomson Financial Datastream

Chart 5.9
Selected SPI sectors



Source: Thomson Financial Datastream

Real effective exchange rate at a historical high

The real trade-weighted external value of the Swiss franc remains at a historically high level (cf. chart 5.7). The exchange rate situation thus continues to present Swiss exporters with a serious problem. As nominal exchange rates tend to even out movements in national price levels, the real exchange rate follows a flat trend line – if with protracted and sometimes considerable fluctuations around that line.

5.4 Stock markets

Temporary recovery in share prices in April and May

In April and May, the share prices of Swiss companies included in the SMI largely made good the losses triggered by the earthquake in Japan in mid-March. However, at the beginning of June, the index again lost ground and in mid-June it was only 3% above the lowest levels for the year, recorded in March (cf. chart 5.8).

The recovery in April and May was an expression of reduced market uncertainty, which can be calculated on the basis of the options on equity indices traded on the futures exchanges. The volatility index of the SMI shows that expected 30-day volatility rose sharply after the earthquake, before declining to its former level. At the end of May, the volatility index of the SMI rose once more because of uncertainty about the debt situation in a number of European countries, and again the rise went hand in hand with falling equity prices.

The sector breakdown of the SPI shows that shares in the industrial and construction sectors posted slight gains between mid-March and mid-June (cf. chart 5.9), against the backdrop of an increasingly solid economic recovery and the pronounced upturn in the housing market. Prices of bank shares decreased a little.

5.5 Monetary and credit aggregates

Monetary base still high

The monetary base, which is composed of banknotes in circulation plus sight deposits of domestic banks with the SNB, remains at a significantly higher level than before the crisis (cf. chart 5.10). Consequently, although the level was substantially lower in May than it had been a year earlier, it was roughly equal to the average for the period since September 2010.

Low money multiplier

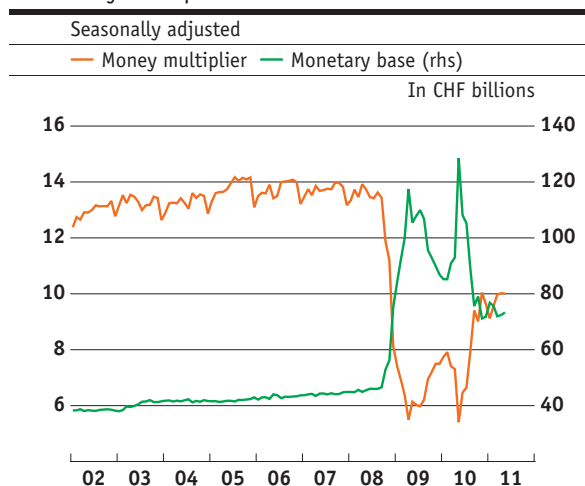
Changes in the money multiplier – which is the ratio of M3, the broadly defined money supply, to the monetary base – are shaped by movements in the monetary base (cf. chart 5.10). The multiplier expresses the extent to which, on the basis of the liquid funds available to them, banks are able to multiply the amount of money available to the general public through lending. The banks have been holding larger quantities of liquid funds for precautionary reasons ever since the crisis began, and the result has been a sharp fall in the money multiplier. Even though the stabilisation of the monetary base in September 2010 largely normalised fluctuations in the multiplier, it is still significantly lower than before the crisis.

Strong growth in the money supply

The M1, M2 and M3 aggregates have also grown strongly since the autumn of 2008 (cf. chart 5.11). In May 2011, M1 (cash in circulation, sight deposits and transaction accounts) was 5.6% above its level a year earlier, while M2 (M1 plus savings deposits) was 5.8% higher. The less volatile M3 money supply (M2 plus time deposits) rose by 5.6% in the same period (table 5.1).

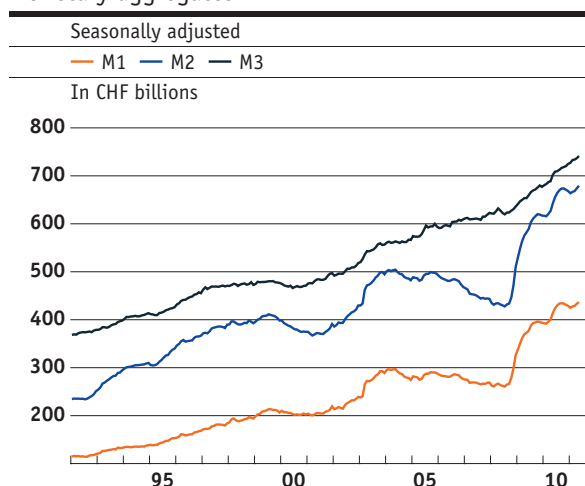
The monetary overhang can be quantified by calculating the percentage deviation of the M3 monetary aggregate from its estimated equilibrium value. Chart 5.12 shows this deviation in the form of a range with a width of one standard deviation, to take account of statistical uncertainty. The indicator lies in positive territory. In earlier phases, this was associated (after a certain time lag) with a rise in inflation.

Chart 5.10
M3 money multiplier



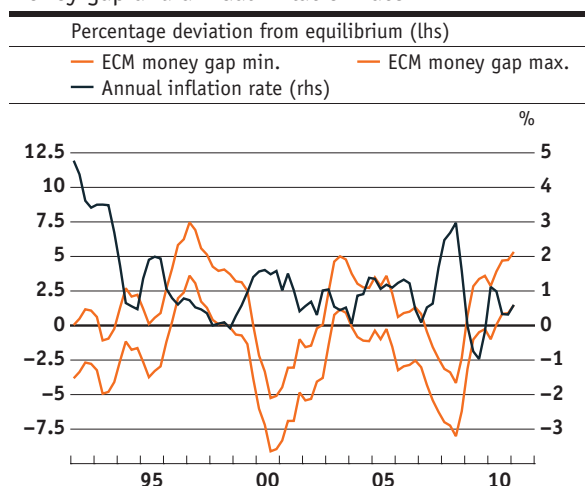
Source: SNB

Chart 5.11
Monetary aggregates



Source: SNB

Chart 5.12
Money gap and annual inflation rate



Source: SNB

| | 2010 | | 2011 | | | 2011 | | |
|---------------------------------------|-------------|-------------|-------------|------------|------------|------------|------------|------------|
| | | Q2 | Q3 | Q4 | Q1 | March | April | May |
| M1 | 10.6 | 10.6 | 10.3 | 9.1 | 8.6 | 8.4 | 8.2 | 5.6 |
| M2 | 10.2 | 10.2 | 9.6 | 8.4 | 7.9 | 7.8 | 7.5 | 5.8 |
| M3 | 6.4 | 6.8 | 6.5 | 6.4 | 7.0 | 6.8 | 7.0 | 5.6 |
| Bank loans total^{1,3} | 3.8 | 4.2 | 3.5 | 3.8 | 3.6 | 3.8 | 3.5 | - |
| Mortgage claims ^{1,3} | 5.0 | 5.1 | 4.9 | 4.7 | 4.6 | 4.7 | 4.7 | - |
| Households ^{2,3} | 4.9 | 4.9 | 4.7 | 4.7 | 4.4 | 4.3 | 4.3 | - |
| Private companies ^{2,3} | 5.2 | 5.3 | 5.1 | 4.6 | 5.2 | 5.4 | 5.4 | - |
| Other loans ^{1,3} | -1.1 | 0.7 | -2.8 | -0.6 | -0.8 | -0.3 | -1.9 | - |
| Secured ^{1,3} | 3.5 | 4.2 | 3.1 | 4.1 | 6.2 | 8.0 | 5.2 | - |
| Unsecured ^{1,3} | -3.9 | -1.4 | -6.4 | -3.5 | -5.1 | -5.3 | -6.2 | - |

1 Monthly balance sheets

2 Credit volume statistics

3 Growth rates for the bank loans item and for its components include information provided by banks on changes in their classification practices. Consequently, they may deviate from growth rates published in the *Monthly Bulletin of Banking Statistics*

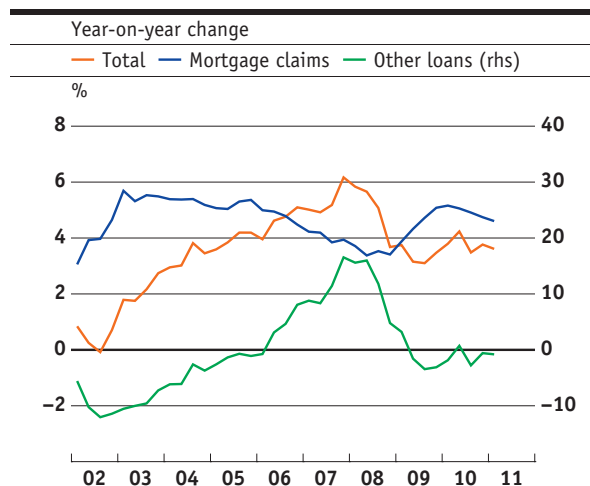
Source: SNB

Continued strong growth in mortgage lending

Bank lending is rising less fast than the growth in the monetary aggregates. However, it remained strong in April, at a year-on-year rate of 3.5%. Growth in lending is being driven by the demand for mortgage lending, which increased by 4.7% within

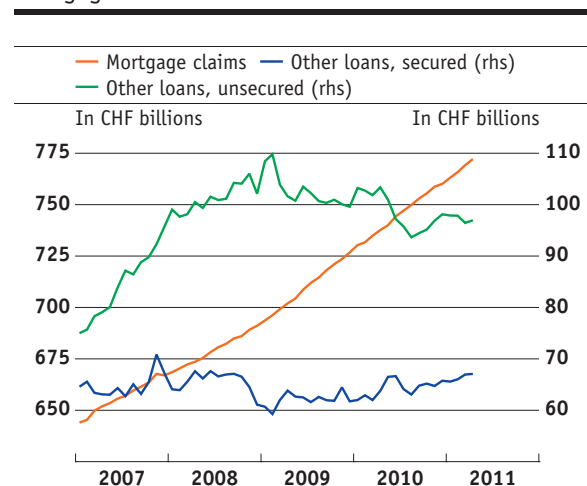
a year (cf. chart 5.13). In the same period, other lending declined by 1.9%. The decline in other lending is attributable to the trend in unsecured lending. Other secured loans actually saw an increase (cf. chart 5.14), though these account for a smaller volume of loans.

Chart 5.13
Growth in bank loans



Source: SNB

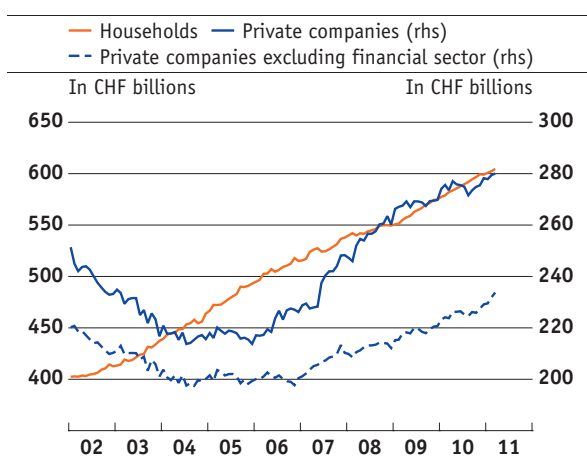
Chart 5.14
Mortgage claims and other loans



Source: SNB

The breakdown of bank lending by borrowers shows that lending to households and to private companies both expanded (cf. chart 5.15). In the corporate field, lending to financial corporations fell while loans to companies in other sectors rose. The decline in lending to financial corporations must be seen in context, however, as such lending has more than doubled in the last four years. Once again, growth in lending to households in the first quarter was slightly down on the previous year. This slowdown in growth bears out the findings of the SNB bank lending survey, which indicates slightly more stringent criteria for lending to households.

Chart 5.15
Loans to households and companies



Source: SNB

Business cycle trends

SNB regional network

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of June 2011

Second quarter of 2011

The Swiss National Bank's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different economic sectors and industries. Their reports, which contain subjective evaluations by these companies, are a valuable source of information for assessing the economic situation. The following pages contain a summary of the most important results of the talks held in April and May 2011 with 211 representatives of various industries on the current and future situation of their companies and the economy in general. The selection of companies is made according to a model that reflects Switzerland's production structure; the companies selected differ from one quarter to the next. The reference parameter is GDP excluding agriculture and public services.

| Region | Delegate |
|------------------------------|---|
| Geneva | Marco Föllmi |
| Italian-speaking Switzerland | Mauro Picchi |
| Mittelland | Anne Kleinewefers Lehner Martin Wyss (acting delegate) |
| Northwestern Switzerland | Hans-Ueli Hunziker (acting delegate) |
| Eastern Switzerland | Jean-Pierre Jetzer |
| Vaud-Valais | Aline Chabloz |
| Central Switzerland | Walter Näf |
| Zurich | Markus Zimmerli |

Summary

After a slight slowdown in the first quarter of 2011, the pace of the economy accelerated again somewhat in the second quarter. The trend was broadly based in terms of the various sectors, but was most apparent in construction. Overall, the demand for labour increased further.

Respondents remain confident as regards developments in the near future. Expectations for the months ahead point to continued growth in turnover in manufacturing, services and, to a lesser extent, construction. All sectors are planning to increase investment. Technical production capacity utilisation in the Swiss economy is normal to very high in all three sectors and looks set to continue growing at a more or less unchanged pace in the months ahead.

Despite the positive trend in business activity, a number of concerns remain. The greatest of these is clearly the debt crisis in Europe and the possible adverse repercussions this may have on the financial markets and the real economy. The export industry is suffering from the heavy pressure that exchange rates are exerting on margins. The environmental disaster in Japan has so far not had any significant impact on the Swiss economy.

As in the previous quarters, reactions to the appreciation of the Swiss franc vary considerably according to sector; overall, the pressure on business has changed little, though it has become more pronounced in the manufacturing industry (cf. 'Exchange rate survey: Effects of Swiss franc appreciation and company reactions', pp. 38–43).

1 Business activity

Manufacturing

The favourable economic situation in the manufacturing industry continued in the second quarter of 2011. Turnover in real terms rose both year-on-year and quarter-on-quarter. The quarter-on-quarter improvement was quite striking, and resulted in a reversal of the slight slowdown in the pace of growth seen in the first quarter.

As in the previous quarter, the sectors that saw above-average gains year-on-year were those that only started to benefit from the economic upturn after a delay. These include watchmaking, metal processing, machinery and machine tools. The electrical and electronic components production sector also performed well.

The robust economic situation is based on continuingly strong stimuli from both the domestic and foreign markets. The export sector is still benefiting from exceptionally strong demand from the emerging economies of Asia and from eastern Europe and the Middle East. The stimuli from the US and South America have strengthened again. Demand from Germany remains brisk, as does that – albeit to a lesser extent – from France, whereas demand in a number of southern European countries fell significantly.

Construction

The rapid pace of business growth in the construction industry that has already been evident for quite some time has continued: turnover has improved considerably on a 12-month perspective but especially quarter-on-quarter. The mild winter and fine spring were of great benefit to construction activity. Turnover remains strong in residential construction and also in the finishing trade. The positive overall trend still looks set to continue.

Once again a number of respondents expressed their concern about real estate market risk. In places, the strong demand for residential properties is now also becoming apparent outside the metropolitan areas, where there have been no such signs of this up to now. Persistently low interest rates are described as ‘not without their dangers for the construction industry’. In many places, capacity in construction-related industries, too, is being pushed to the limit; order books are ‘as full as they have ever been’ in some areas.

Services

In the services sector, turnover figures were higher both year-on-year and quarter-on-quarter. The pace of growth has increased slightly.

The strongest rates of growth were recorded by recruitment firms, transport, hospitality and the IT sector. Here, turnover was considerably higher than in the previous quarter. Auditors, fiduciary companies, the financial sector and wholesalers also showed a robust business performance. By contrast, the retail trade was still very volatile. In many places, consumer sentiment remains muted. In this respect, the situation appears to be particularly difficult in food, sporting goods and multimedia. Whereas in border regions this may be explainable in part at least by the exchange rate, retailers in other regions are frequently mystified. Owing to the weakness of the euro, the popularity of ‘cross-border shopping’ by Swiss residents has increased again, especially for big-ticket purchases.

2 Capacity utilisation

Having fallen slightly in the first quarter, the degree of technical capacity utilisation rose substantially again. The increase was particularly strong in manufacturing and construction. In manufacturing, utilisation was rated as normal to high and in the construction sector as high to very high. As in the previous quarter, some companies did, however, report a conflict between utilisation and profitability, which had even forced a few of them to turn down orders.

Capacity utilisation was very high in watchmaking, and on the high side among manufacturers of electronic components and chemicals. Under-utilisation was reported by some food industry businesses.

The construction industry saw a continued increase in technical capacity utilisation from the previous quarter. All the respondent firms were very satisfied with utilisation of their capacity, and some of them would have liked their business to be proceeding at a somewhat slower pace. Company representatives expect capacity utilisation to rise again in the months ahead; there are no signs of any weakening.

In the services sector, capacity utilisation was normal – as in the preceding quarters. The areas with the highest levels of utilisation were staff recruitment, engineering companies, architectural practices and consulting firms. The transport sector and software manufacturers also reported relatively high capacity utilisation. Utilisation was normal in the financial sector, while the hotel trade and retailers complained of slight underutilisation.

3 Demand for labour

In manufacturing, the favourable trend in business activity continued to have a positive impact on the demand for labour. Overall, representatives of manufacturing companies considered their manpower levels to be on the low side. Compared with the first quarter, there was an increase in the amount of extra labour needed. Companies are tending to be less cautious in hiring new staff. A marked shortage of manpower was reported in the machinery and machine tools industry, the electrical and electronic sector and watchmaking.

In the construction industry, too, the demand for labour rose slightly. Although the majority of respondent companies were satisfied with the size of their current workforce, the difficulties that a number of them are experiencing in recruiting suitable employees have intensified. In some instances, a lack of adequate personnel resulted in bottlenecks.

In the services sector, staff levels were generally considered appropriate to a little too low. IT firms reported a considerable need to recruit personnel. Staff levels were also seen as being on the low side by architectural practices, engineering consultants and planning offices. The hotel industry is still slightly overstaffed.

Difficulties in hiring labour have increased further in all sectors, which reflects the growing tightness of the labour market. This phenomenon was particularly pronounced in electronics, machinery, transport and IT firms. Generally speaking, it was still proving rather hard to find specialists and well-qualified staff. As before, however, the retail and hotel trades are not experiencing any significant recruiting problems.

Per capita labour costs continued to rise in most business sectors. In some industries, higher demand for personnel and the tight labour market were pushing up costs. Moreover, fluctuation rates were on the rise in some areas. In this connection, companies often mention the considerable advantages of the free movement of persons. Companies in the food, electronic and machinery industries and in watchmaking, in particular, were faced with higher per capita labour costs. The construction sector continued to be hit by wage pressure. In the services sector, it was mainly IT firms, property companies, consultancies, transport companies and banks that reported higher labour costs.

4 Prices, margins and earnings situation

Overall, the margins situation remained unfavourable in the second quarter as well, i.e. below the levels regarded as normal. This can be ascribed mainly to the strength of the Swiss franc and rising commodity prices. Where possible, businesses are trying to counter the pressure on margins by changing their product mix (i.e. switching to products generating more added value) or expanding the related services they offer. In the euro area, moreover, rising inflation means that prices can be raised somewhat.

It was manufacturing once again which suffered most from the depressed profit margins. On the one hand, margins are being squeezed by the higher Swiss franc exchange rate; on the other, competition remains fierce and has intensified in some areas. Margins are also likely to remain under pressure, since companies expect purchase prices to continue rising but are hardly able to increase Swiss franc selling prices to the same extent. All the same, the upward pressure on purchase prices is expected to be a little less strong than in the previous quarter.

In construction, as in the previous quarter, profit margins were judged to be close to normal. Company representatives expected the growth in commodity purchase prices to accelerate. Moreover, businesses felt there was a greater possibility of achieving higher selling prices than in the previous quarter. Their margins situation might therefore improve further in the coming months.

In general, respondents in the services sector regarded their profit margins as largely normal. The overall result was still being adversely affected by the clearly unsatisfactory margins of the banks – a consequence not only of low interest rates but also of exchange rate movements, which depressed asset management income. Recruitment firms, fiduciary companies, consultancies, IT firms and hotels also rated their profit margins as relatively unsatisfactory. By contrast, travel agencies, real estate management companies and retailers reported a relatively normal margins situation.

As in the previous quarters, companies in the April/May 2011 survey were again asked about the impact that the Swiss franc's appreciation has had on their business. Even though the exchange rate situation has deteriorated further since the last survey, overall, there was little change from their assessment in the first quarter of 2011: 48% of firms stated that they were experiencing negative effects overall; 37% of businesses were unaffected by the appreciation; and 15% reported positive effects. Once again it was manufacturing that was worst hit by the strength of the Swiss franc; compared to the previous quarter, pressure on this sector had increased somewhat (cf. 'Exchange rate survey: Effects of Swiss franc appreciation and company reactions', pp. 38–43).

5 Outlook

The outlook for business activity, employment and investment remains positive overall. Many company representatives remain cautiously optimistic.

The majority of manufacturing company representatives anticipate continuing growth in turnover and higher capacity utilisation in the next six months. Compared to the previous quarter, more hiring is planned.

Companies in the construction industry remain largely optimistic: the positive trend in both turnover growth and intended employment is strengthening. The expected increase in capacity utilisation, however, is not estimated to be quite as large as in the first quarter. Order books are generally full for many months to come.

In the services sector, too, companies rate their business prospects in the next six months favourably overall and are anticipating a further increase in the corresponding figures. Turnover growth is projected to be minimally lower than in the previous quarter, however. Representatives of hospitality businesses and the IT sector rate their turnover prospects very optimistically indeed. Travel agents and recruitment firms are also positive. Many retailers are hoping that consumer spending will rise in the coming months. The hotel trade is taking a rather cautious but by no means negative view of future prospects. However, the sector has been performing much better in cities than in the mountain regions.

With regard to international risks, attention has shifted back a little more to the possible adverse repercussions of the European debt crisis. Quite a few industries are still faced with rising commodity prices. The Fukushima disaster could have an impact in the coming months in the form of supply bottlenecks and price rises for certain categories of product. The future development of energy prices is a further source of concern. So far, no risks to the Swiss economy have emanated from the political unrest in North Africa and the Middle East.

Business representatives are also concerned, in particular, about the erosion of margins, increasing labour shortages and a further appreciation of the Swiss franc. Since the respondents expect purchase prices to increase less strongly in the months ahead than they did in the previous quarter but think they can achieve higher selling price mark-ups, their margins could improve a little. As in previous quarters, some respondents expressed unease about the continued low level of interest rates. As regards the further development of the economic situation, uncertainty has declined somewhat overall.

Capital spending continued to show an upward trend in all three sectors. The manufacturing industry in particular is proposing a further increase in equipment investment. The construction sector, too, is reporting further capital expenditure requirements. In real estate investment, it is mainly the services sector that is projecting higher expenditure. However, among some manufacturing companies, there is talk of gradually cutting back investment in Switzerland in favour of new investment abroad.

Exchange rate survey: Effects of Swiss franc appreciation and company reactions SNB regional network

Report for the attention of the Governing Board of the Swiss National Bank
for its quarterly assessment of June 2011

Second quarter of 2011

In the economic survey for the second quarter, which was carried out in April and May 2011, delegates from the SNB's regional network systematically raised the exchange rate issue with companies again, posing questions with the aim of quantifying the effects of the appreciation of the Swiss franc. A total of 210 companies took part in the survey. The selection of companies is made according to a model that reflects Switzerland's production structure. The companies selected differ from one quarter to the next. The reference parameter is GDP excluding agriculture and public services.

1 Overall results of the survey

For the economy as a whole, there was little or no change in the results compared to the previous quarter, despite a further intensification in the exchange rate situation since the last survey. A total of 48% of respondent companies (previous quarter: 47%) claimed to be experiencing negative effects from the appreciation of the Swiss franc (24% significantly and 24% moderately negative). As in the previous quarter, 37% of companies said they were not feeling any appreciable effects on their business activity from the appreciation of the Swiss franc. As can be seen from chart 2, these are mainly companies that have no exchange rate exposure. In addition, hedging strategies or mutually offsetting factors help to neutralise exchange rate effects. Accordingly, the vast majority of these companies are not anticipating any impact in the near future either (cf. chart 3).

Positive effects from the appreciation of the Swiss franc were experienced by the remaining 15% of companies included in the survey.

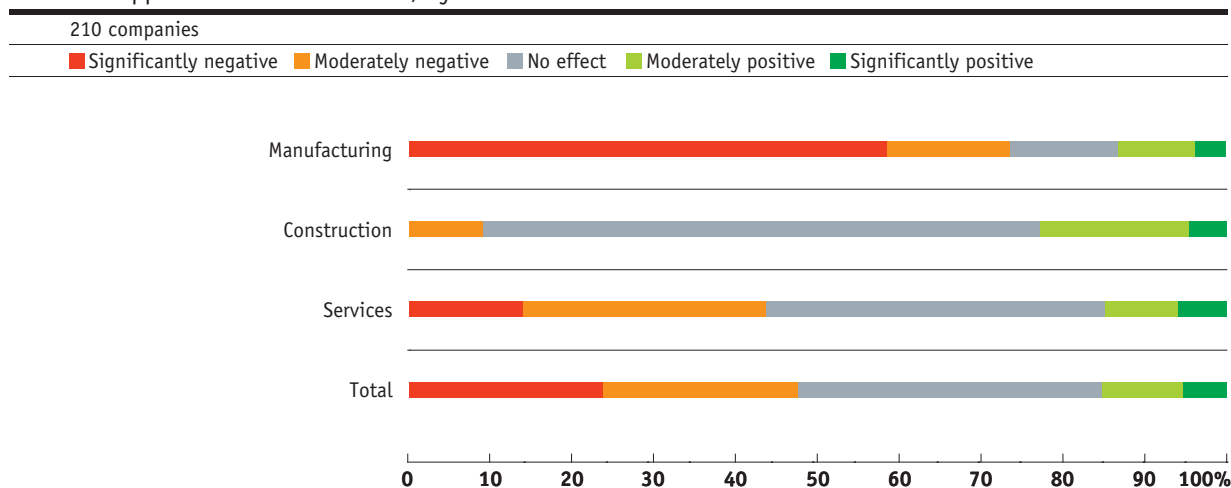
The proportion of companies in the manufacturing industry that felt significantly negative effects rose from 51% to 58%, however. The problem seems to have worsened in those areas where it already existed, if in a less pronounced form. Since the proportion experiencing moderately negative effects halved to 14%, the overall proportion of companies affected declined a little from 79% to 73%. In the services sector, the majority of companies (57%) were spared negative effects from the strength of the Swiss franc. The division of com-

panies into those experiencing significantly negative (13%) and moderately negative (30%) effects also remained unchanged. In the construction industry, the proportion of companies positively affected (22%) was significantly smaller than in the previous period. Accordingly, the proportion of companies not affected rose from 60% to just under 70%. It should be noted that industrial companies with construction-related activities that reported negative effects due to fiercer competition from abroad are included under manufacturing. They do not, therefore, affect this survey's results for the construction industry.

2 Negative effects – where and how?

In all, 100 companies reported moderately or significantly negative effects from the appreciation of the Swiss franc. Chart 4 shows the markets where these negative effects were observed and the form they took. As previously, export activities were worst hit. In most cases, the companies that were adversely affected found themselves faced with lower profit margins in their foreign sales markets (two-thirds of companies) and lower Swiss franc-equivalent selling prices (over 40% of companies). The phenomenon of unsatisfactory selling prices was, however, slightly less prominent than in the previous quarter, which suggests that some Swiss exporters were able to achieve higher selling prices in foreign currencies and so offset the appreciation to a certain extent.

Chart 1
Effects of appreciation of Swiss franc, by sector



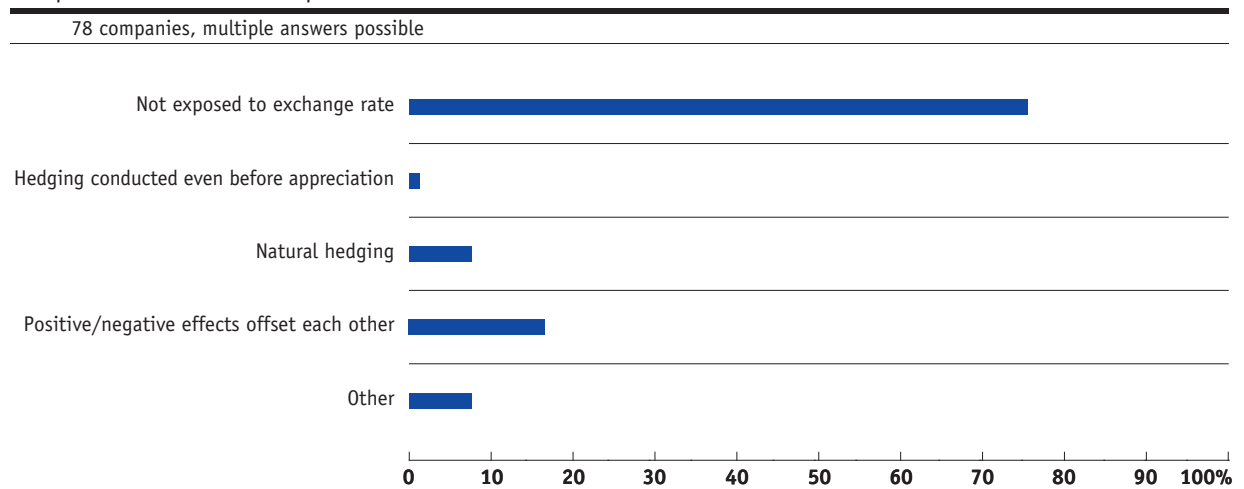
Source: SNB

In addition to the direct impact on the export industry, indirect effects were also reported (cf. lower third of chart 4) by export industry supply companies or businesses exposed to competition from cheaper imports.

The industries worst hit by the appreciation of the Swiss franc were chemicals, metals, manufacturers of electronic products and precision instruments, plus the machinery, textiles and clothing industries. Compared to the previous quarter's survey, the results for the hotel industry remained more or less unchanged. Of the total of 18 hotel representatives interviewed, nine reported moderately negative effects from the appreciation and two reported significantly negative effects; the other seven hotel representatives said the strength of the Swiss franc had no appreciable impact. In

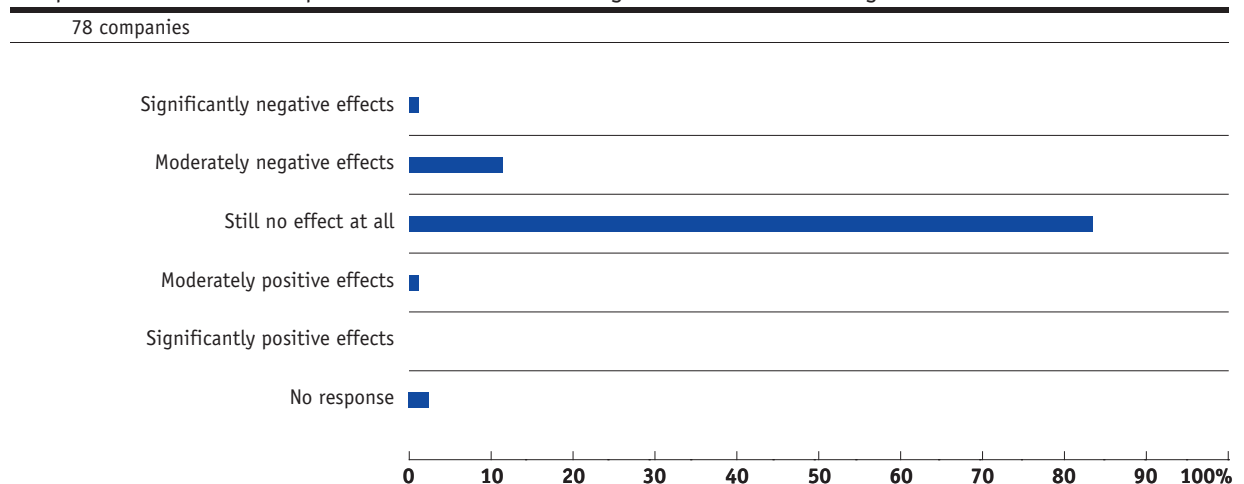
this respect, tourism has been performing much better in cities than in the mountain regions. The situation in the retail industry continued to vary considerably. Retailers in border areas, in particular, were faced with unfavourable developments in cross-border shopping tourism; elsewhere, however, the positive effects of lower purchase prices dominated. In the wholesale industry, too, responses varied between these two extremes, with the average effect being rated as moderately negative. On the whole, banks reported negative effects. By contrast, representatives of the motor trade, real estate management companies and brokers, fiduciary companies, consultancy firms and recruitment agencies generally reported either no effects or positive effects.

Chart 2
Companies not affected: explanations



Source: SNB

Chart 3
Companies not affected: expectations while the exchange rate remains unchanged



Source: SNB

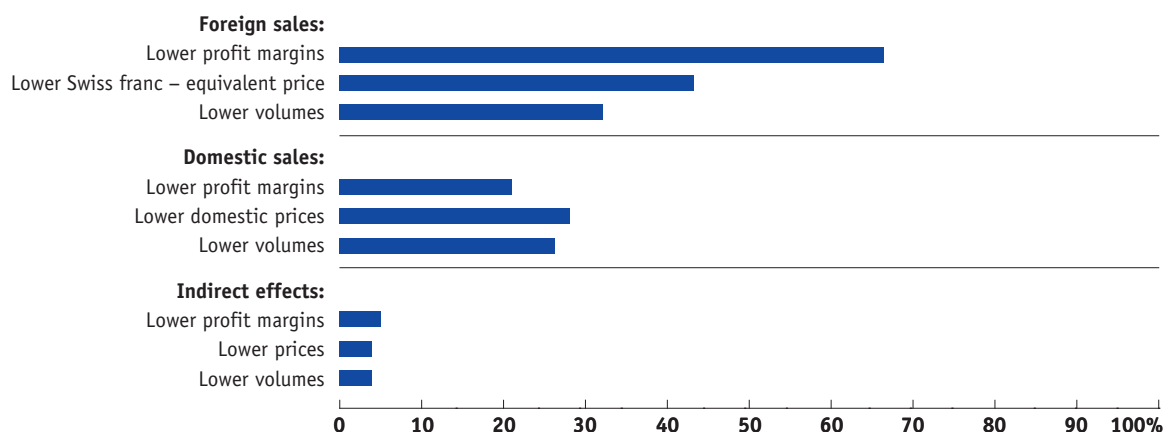
3 Negative effects – how are companies reacting?

Companies were also asked about the measures they have already taken to counter the effects of the Swiss franc's appreciation. Chart 5 shows the range of these reactions. In this respect, too, the results were very close to those of the previous quarter. A large majority of companies have taken measures. Those most frequently taken are aimed at reducing production costs. Labour costs are mainly being cut by lowering the headcount or by deciding not to recruit new staff. In most cases, however, the cost-cutting measures affect the other costs of production. The use of hedging strategies, mainly in the form of natural hedging, is very widespread.

However, as in the previous quarter, just over 30% of negatively affected companies said they were also engaging in fundamental strategic thinking about the future of their companies.

Chart 4
Negatively affected companies: effects of appreciation of Swiss franc

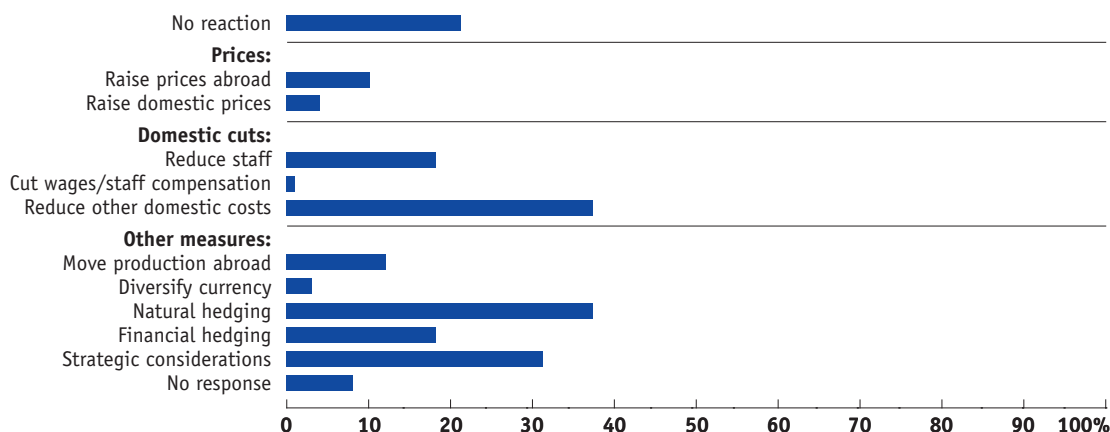
100 companies, multiple answers possible



Source: SNB

Chart 5
Negatively affected companies: reactions to appreciation of Swiss franc

100 companies, multiple answers possible



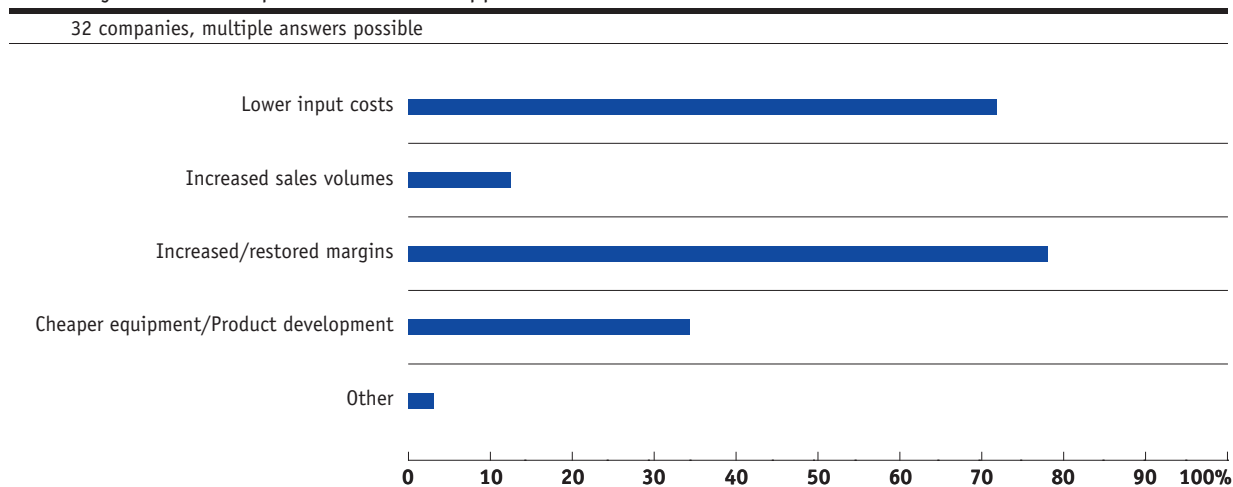
Source: SNB

4 Positive effects – where and how?

A total of 32 respondent companies (15%) were experiencing minimal or even significantly positive effects from the appreciation of the Swiss franc. As can be seen from chart 6, the greater part of the positive effects came in the form of lower input costs (around 70% of cases) and/or improved profit margins (just under 80% of cases).

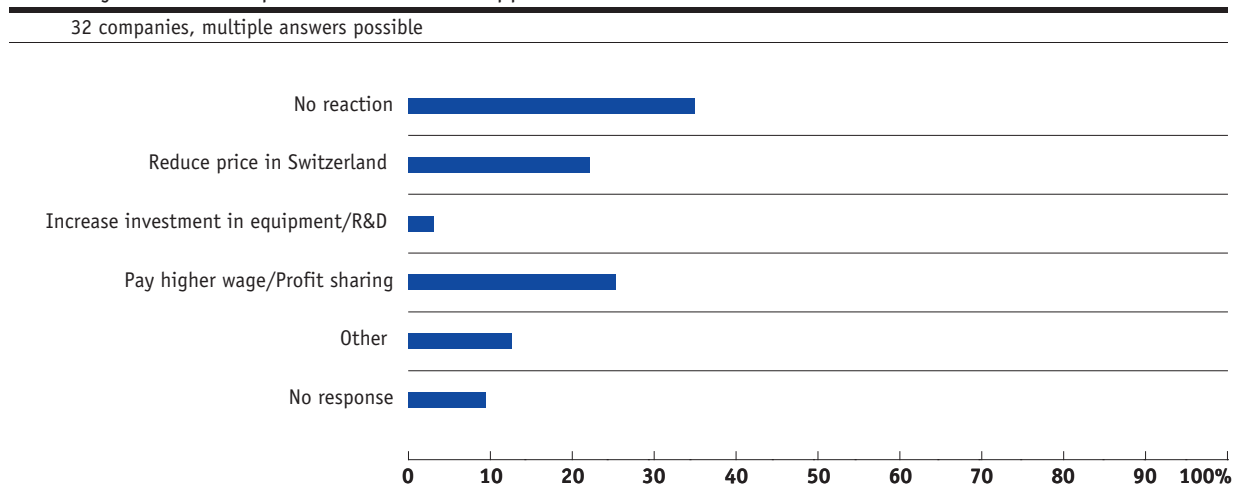
In addition, a third of companies mentioned more favourable conditions for investment and for research and development. As can be seen from chart 7, this improvement in business conditions will probably lead primarily to an increase in these companies' profits and liquidity, since only a minority of companies that were positively affected reduced their selling prices (22%) or increased wages and profit-sharing in response to the appreciation.

Chart 6
Positively affected companies: effects of appreciation of Swiss franc



Source: SNB

Chart 7
Positively affected companies: reactions to appreciation of Swiss franc



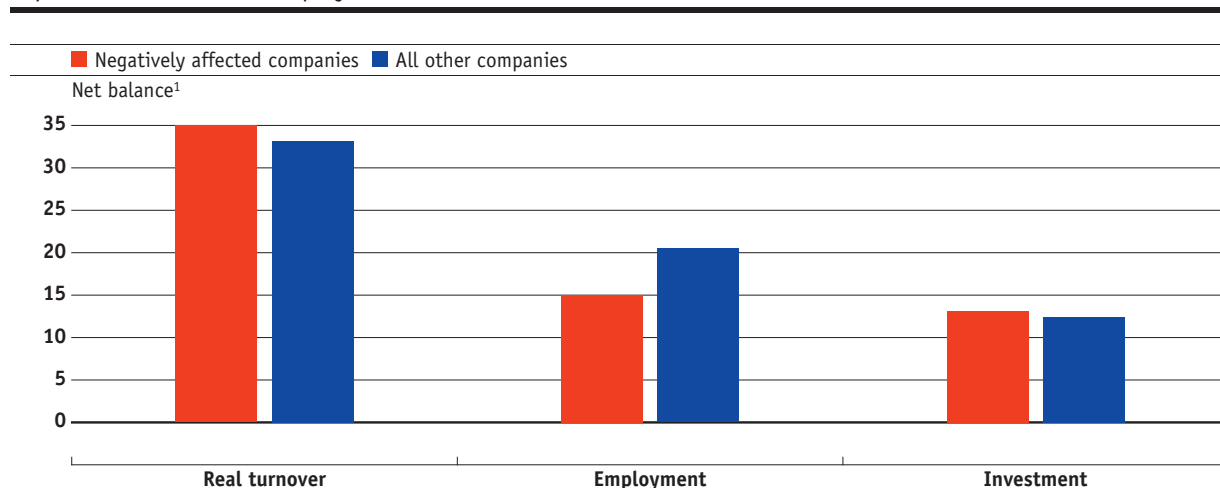
Source: SNB

5 Expectations for the near future remain positive

In the survey, companies were asked about their expectations about real turnover, staff numbers and investment in the coming six/twelve months. Their answers are recorded on a scale ranging from 'significantly higher' to 'significantly lower'. Based on this information, an index is created by subtracting the negative assessments from the positive ones (net assessments). Significantly positive and significantly negative assessments are assigned higher weights than slightly positive or slightly negative assessments. The index is constructed in such a manner that its value can range between +100 and -100. A positive index value reflects positive assessments overall, while a negative value shows negative assessments overall.

The evaluation was conducted for two sub-groups – first, companies affected negatively by the appreciation of the Swiss franc, and second, all other companies. On balance, company assessments show that they are expecting increasing turnover and a moderate rise in staff numbers and investment expenditure, as can be seen in chart 8. The chart also reveals that the expectations for these three areas do not differ significantly in the two sub-groups of companies. Despite the intensification in the exchange rate situation since the last survey, these results are, overall, very similar to those of the previous quarters.

Chart 8
Expectations: turnover, employment and investment



1 Weighted positive estimates of companies minus weighted negative estimates regarding the future development of real turnover, employment and investment. The time horizon is 6 months (for real turnover and employment) or 12 months (for investment).
Source: SNB

Chronicle of monetary events

The chronicle summarises the most recent monetary events.
For events dating further back, please refer to SNB press releases
and the *Annual Report* at www.snb.ch.

June 2011

At its quarterly assessment of 16 June 2011, the SNB decides to maintain its expansionary monetary policy. The target range for the three-month Libor remains unchanged at 0.0–0.75%, and the SNB intends to keep the Libor within the lower part of the target range at around 0.25%. For 2011, the SNB is maintaining its forecast of real GDP growth of around 2%. The conditional inflation forecast shows that the expansionary monetary policy cannot be maintained over the entire forecast horizon without compromising price stability in the long term.

March 2011

At its quarterly assessment of 17 March 2011, the SNB decides to maintain its expansionary monetary policy. It leaves the target range for the three-month Libor rate unchanged at 0.0–0.75%, and intends to keep the Libor within the lower part of the target range at around 0.25%. Although global economic developments were better than the SNB had expected, international risks remain considerable. The conditional inflation forecast shows, however, that the expansionary monetary policy cannot be maintained over the entire forecast horizon without compromising price stability in the longer term.

On 3 March 2011, the SNB reports a consolidated loss of CHF 19,170.8 million for 2010, following a profit of CHF 9,955.0 million in 2009. The annual result was overwhelmingly dominated, once again, by currency movements.

December 2010

On 21 December 2010, the SNB announces that – in coordination with the Bank of Canada, the Bank of England and the European Central Bank – the swap agreement with the US Federal Reserve will be extended until August 2011.

At its quarterly assessment of 16 December 2010, the SNB decides to hold the target range for the three-month Libor at 0.0–0.75% and to keep the Libor in the lower end of the range, at around 0.25%. It also stresses that it would take the measures necessary to ensure price stability should the tensions in the financial markets be exacerbated and a deflation threat emerge.

September 2010

On 16 September 2010, at its quarterly assessment, the SNB leaves the target range for the three-month Libor unchanged at 0.0–0.75% and still intends to keep the Libor at around 0.25%. It also points out that it would take the measures necessary to ensure price stability should downside risks materialise and lead to a renewed threat of deflation.

June 2010

At its quarterly assessment of 17 June 2010, the SNB decides to maintain its expansionary monetary policy. It leaves the target range for the three-month Libor unchanged at 0.0–0.75% and continues to aim for a Libor around 0.25%. It also notes that the threat of deflation has largely disappeared. In view of the high downside risks, however, it stresses that it would take all measures necessary to ensure price stability should these risks materialise and, via an appreciation of the Swiss franc, lead to a renewed threat of deflation.

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